

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CAGUAS

AUDITORIA 2003-2004

30 DE JUNIO DE 2004

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DE ASUNTOS MUNICIPALES

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SINGLE AUDIT PACKAGE
Fiscal Year Ended
June 30, 2004

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

Hon. William Miranda Marín
Mayor
Commonwealth of Puerto Rico
Municipality of Caguas

We have audited the basic financial statements of the Municipality of Caguas (Municipality) as of and for the year ended June 30, 2004 and have issued our report thereon dated January 24, 2005. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However we noted certain matters on internal control over financial reporting 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 financial reporting that, in our judgment could adversely affect the Municipality's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as item 2004-1.

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Municipality of Caguas
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A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the 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 condition, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We believe that the reportable condition described above is a material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Mayor, the Municipal Assembly, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



January 24, 2005

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

Hon. William Miranda Marín
Mayor
Commonwealth of Puerto Rico
Municipality of Caguas

Compliance

We have audited the compliance of the Municipality of Caguas (Municipality) 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'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's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America; and OMB 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 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's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances.

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Hon. William Miranda Marín
Mayor
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Municipality of Caguas
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We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Municipality's compliance with those requirements.

In our opinion, the Municipality complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004.

Internal control over compliance

The management of the Municipality of Caguas 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'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.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a time period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance and its operation that we consider to be material weaknesses.



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Hon. William Miranda Marín
Mayor
Commonwealth of Puerto Rico
Municipality of Caguas
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This report is intended solely for the information and use of the Mayor, the Municipal Assembly, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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January 24, 2005

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the Fiscal Year Ended June 30, 2004

SECTION 1 – SUMMARY OF AUDITOR'S RESULTS

Financial Statements:

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- | | |
|--|-----|
| 1. Material weakness identified? | Yes |
| 2. Reportable condition(s) identified that are not considered to be material weakness? | No |
| 3. Noncompliance material to financial statements noted? | No |

Federal awards:

Internal control over major programs:

- | | |
|---|----|
| 1. Material weakness(es) identified? | No |
| 2. Reportable condition(s) that are not considered to be material weaknesses? | No |

Type of auditor's report issued on compliance for major program? Unqualified

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510 (a)? No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
14.218	Community Development Block Grant Entitlement
93.600	Head Start Administration for Youth and Children
14.239	Home Investment Partnership Program
14.871	Section 8 Housing Choice Voucher
14.850	Public and Indian Housing

Dollar threshold used to distinguish between Type A and Type B programs: \$960,403

Auditee qualified as a low-risk auditee? No

SECTION 2 – FINANCIAL STATEMENT FINDINGS

Finding No. 2004-1

Program CFDA No. / Grant No.:	N/A
Type of Reportable Condition:	Internal Control Structure Design Material Weakness
Questioned Cost:	None

Condition:

We noted the following internal control situations in the use of the SAP Accounting System.

1. Significant differences existed between the amount capital asset acquisitions per capital asset subsidiary and the total of capital expenditures per Appropriations, Encumbrances, Expenditures and Fund Balance Reports of all funds. In addition, the trial balances of governmental funds per SAP System did not include the capital expenditure accounts.
2. The Municipality did not account in its unadjusted trial balances the accounts receivable and deferred revenues of government mandated transactions related to federal awards.

Criteria:

Puerto Rico municipalities should implement accounting system that is in accordance with generally accepted accounting principles. [Puerto Rico Municipality Law (Law 81), article number 8.010].

Specifically, Puerto Rico municipalities should record their financial transactions using fund accounting. [Puerto Rico Municipality Law (Law 81), article number 8.010(b)].

Generally accepted accounting principles applicable to governmental entities through the GASB Statement No. 33 and 34 establish the principles required to account for non-exchange transactions and capital assets.

Cause:

1. There are no adequate and periodic reconciliation procedures between the data maintained in the capital assets subsidiary maintained in the Capital Assets Area with the capital expenditures recorded in the Appropriations, Encumbrances, Expenditures and Fund Balance report generated in the Accounting Area.
2. The consultants that trained the Finance Department Staff in the management of the SAP System designed the trial balances by fund without including the expenditure accounts related to capital asset acquisitions.
3. The information related to grant agreements is filed through the different departments of the Municipality and not readily available and centralized in the Finance Department. Therefore, this situation caused that the amount due from federal agency and deferred federal revenue are not updated from year to year.

Effect

These situations caused that significant audit adjustments had to be proposed in order to obtain reasonable assurance about the receivable, deferred revenues and capital expenditures balances at June 30, 2004.

Recommendations:

Capital assets:

We suggest that the Municipality's Finance Director provides instructions in order to achieve that periodic reconciliations be performed between the information recorded in the capital assets subsidiary with the capital expenditures recorded in the Accounting Area. The capital assets acquisitions related with equipment, furniture and vehicles should be recorded in the capital assets subsidiary immediately as the units are received in the Municipality. The capital asset acquisitions related with construction public works (construction, engineers and architects) should be recorded immediately when the related contractors' certifications are approved by an authorized Municipality's Executive, Secretary or Director.

It is very important that the employee responsible of the recording of capital assets periodically records the capital asset acquisitions and provides the necessary information to the Accounting Area to record the capital expenditure in the corresponding fund. The final outcome should be that the amount of capital assets additions for the period, which should be provided by the employee responsible of the Capital Assets Area through the subsidiary of capital assets, be the same as the total of capital expenditures recorded in the Appropriations, Encumbrances, Expenditures and Fund Balance report, which should be generated by the employee responsible of the Accounting Area.

Finally, we suggest that the Municipality's Finance Director contact the designers of the Accounting Module of the SAP System in order to revise the trial balances of governmental funds to include the capital expenditures accounts and balances as part of such trial balances. The trial balances of governmental funds should be prepared using the modified accrual basis of accounting and capital assets acquisitions reported as expenditures and not as assets, since these do not involve the use of current financial resources.

Accounts receivable:

GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange transactions*, establishes that the appropriate asset recognition point for assets in any non-exchange transaction is when an enforceable legal claim to resources arises, based on the specifications of enabling legislation or contractual requirements. Based on this, the Municipality has to recognize an account receivable when the delegation funds' contracts or federal grant awards are approved by the federal agency and therefore should consider the following:

- a) The amounts of the receivable at any specific date should be the amount resulting from the difference between the amount approved by the federal agency in the contracts less the draw-downs or the transfers of funds received by the Municipality from the federal agency at the balance sheet date.
- b) The balance of accounts receivable should be updated periodically and subsidiaries should be maintained in the Municipality's Finance Department for each individual grant agreement or contract approved by the corresponding federal agency. The Finance Department should have copy of each effective grant agreements in order to have an accurate starting point for the determination of amounts due from federal agencies.

Revenues and deferred revenues:

The Municipality receives federal funds from various federal agencies as a grantee and sub-grantee. In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange transactions*, this kind of revenues are classified as a government mandated non-exchange transactions, which result when one level of government provides resources to a government at another level, requiring the use of the resources for a specific purpose as established in enabling legislation.

Under government mandated non-exchange transactions, revenues are recognized in the period when all eligibility and time requirements have been met. When the modified accrual basis of accounting is used, resources should be available to pay current year obligations. Resources not available to pay current year obligations under the modified accrual basis are reported as deferred revenues.

In the case of the Municipality, it has two types of federal grants: advances and reimbursement grants. In the case of federal grants that operate by the advance method of cash management, total revenues under the modified accrual basis should be the amounts collected during the year ended June 30, 2004, including those collections received through transfers during the period of sixty (60) days after the balance sheet date. In the case of grants that operate under the reimbursement method of cash management, total revenues should be based on the allowable expenditures incurred (expenditure driven approach), in a way that revenues are equal to expenditures. Resources not expended at the balance sheet date are reported as deferred revenues.

We suggest to the Municipality's Finance Director to identify in a summary list all of the Municipality's federal financial awards and to identify the method of cash management required or established in the grant agreement or in the program requirements. This will be useful in the determination of revenue resulting from the corresponding grant and its accounting in the funds under the modified accrual basis.

SECTION 3 – FEDERAL AWARDS FINDINGS

There were no audit findings that need to be reported in accordance to OMB Circular A-133.

REPORT ON THE STATUS OF UNCORRECTED MATERIAL FINDINGS AND RECOMMENDATIONS FROM PRIOR AUDITS THAT AFFECT THE FINANCIAL STATEMENT AUDITS AS REQUIRED BY GOVERNMENT AUDITING STANDARDS

Finding No. 2003-1

Audit finding description:

We noted the following internal control weaknesses in the use of the OCAM Accounting System.

- *Loan transactions of the Community Development Bank (the Bank) per OCAM Accounting System are not reconciled with the detailed accounting records maintained in the Bank.*
- *The Municipality does not perform monthly reconciliations between cash control accounts in the OCAM Accounting System and the bank reconciliations for the General and Head Start bank accounts. In addition, the bank reconciliations of the Head Start fund from July 2002 to May 2003 were prepared during the month of July 2003, and the bank reconciliation of the month of June 2003, was prepared on August 2003.*
- *There is no accurate detail of the expenditures accounts 99.99, Payments of Prior Year Obligations, in the Municipality's accounting system.*

Audit finding status:

Corrective action was taken.

Findings 2002-2 and 2001-2

Audit finding description:

The Municipality does not perform monthly bank reconciliations with the cash control accounts in the general ledger.

Un-reconciled items include the following situations:

- *Electronic bank transfers of cash remitted from various federal agencies, as well as interests on such accounts not booked on accounting records.*
- *Considerable amount of outstanding checks not booked in the accounting records.*
- *Disbursements restricted for loans approved by the Municipality's Economic Development Bank and construction projects financed through various loans approved by the Governmental Development Bank for Puerto Rico not booked in the accounting records.*

Audit finding status:

Corrective action was taken.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS AS REQUIRED BY OMB CIRCULAR A-133

Findings 2003-2 and 2002-6

Major program:

Section 8 Housing Choice Vouchers.

Audit finding description:

During fiscal year ended June 30, 2003, the Municipality did not minimize the amounts maintained in bank accounts for the Section 8 Housing Choice Vouchers.

Audit finding status:

Corrective action was taken.

Finding 2003-3

Major program:

Head Start

Audit finding description:

We noted the following situations for the Head Start Program:

- *During our physical inspections of a sample of eleven (11) property units acquired during year 2002-2003, two (2) items for \$20,092 were not marked with the property identification number.*
- *One (1) item for \$20,000 did not have the Property Maintenance Sheet.*
- *The above mentioned item of \$20,000 was not included in the Municipality's capital assets subsidiary at June 30, 2003.*

Audit finding status:

During our sample selection we noted that all equipment items tested were property marked with an identification number and recorded in the capital assets subsidiary. Because the Municipality acquired and started to use a new accounting system, the Property Maintenance Sheet was not necessary to be used anymore. As a result, condition was corrected.

Finding 2003-4

Major program:

Community Development Block Grant.

Audit finding description:

During fiscal year ended June 30, 2003, the Municipality disbursed funds for \$18,079 from the Community Development Grant fund to cover payroll costs of services provided by an employee which worked full time in activities of the Section 8 Housing Choice Voucher Program.

Audit finding status:

We performed a sample selection of payment to employees that are paid with CDBG funds, including the one that originated the finding during the prior year audit, and noted that all of them were working in activities related with the Community Development Grant program. As a result, the condition that caused the situation of this finding was corrected. The reimbursement by the Municipality for the amount of the questioned cost was in process.

Finding 2003-5

Major program:

Community Development Block Grant.

Audit finding description:

The Municipality did not perform adequate oversight and/or monitoring procedures regarding the use of funds donated and/or delegated during the year ended June 30, 2003 to the following entities:

<u>Entity</u>	<u>Amount of donation</u>	<u>Purpose of donation</u>
INOTEF	\$ 53,800	Public Service
University of Turabo	100,000	Construction of museum

Audit finding status:

In the case of INOTEF the Municipality provided and we examined the documents that evidenced that during the year ended June 30, 2004, the Municipality performed monitoring procedures related to the contract of delegation of funds formalized between the Municipality and INOTEF and no exceptions were noted. In the case of the University of Turabo, the Municipality performed monitoring procedures to the construction of a museum by obtaining and examining the University's contractor certification that evidenced the construction costs incurred by the University in the project for which the Municipality delegated the funds.

As a result, we considered that in both cases the condition was corrected.

Finding 2003-6**Major program:**

Community Development Block Grant.

Audit finding description:

The Municipality did not perform on-site inspections in the housing units of the following beneficiaries of the Minimum Rehabilitation Project:

<u>Name</u>	<u>File number</u>
Francisca Ocasio Flores	02-0084
Carmen G. Delgado	02-0119
Margarita Borges Márquez	02-0135
Nancy Ortiz Díaz	00-0453

Audit finding status:

We performed a sample selection of files of beneficiaries of the Minimum Rehabilitation activity and noted that the Municipality performed the on-site inspections in all cases tested. As a result condition was considered corrected.

Finding 2003-7

Major program:

Head Start.

Audit finding description:

The Financial Status Report of the period from January to December 2002 did not tie with the Head Start Program accounting records.

Audit finding status:

We obtained the Financial Status Report from January to December 2003 and 2004 and we could verify that the information recorded in the Municipality's accounting records are in agreement with those included in such reports. As a result condition was corrected.

Finding 2003-8

Major program:

USDA Child Care Food Program.

Audit finding description:

During fiscal year ended June 30, 2003, the Municipality transferred funds for \$11,515 from the Child Care fund to the of bank account of Rents from Consolidated Mall account for the cost of utilities included in the rent contract for the use of the Child Care food warehouse . As per written communication issued by the United States Child Care Nutrition Division of the US Department of Agriculture, paragraphs 19c and 21b, the cost of utilities is not allowable to be paid with the rent.

Audit finding status:

The Municipality is not paying anymore the cost of utilities with USDA funds. As a result, the condition that caused the situation of this finding was corrected. The reimbursement, by the Municipality, of the amount of the questioned cost was in process.

Finding 2002-7**Major program:**

Head Start, Community Development Block Grant, Home Investment Partnership and Section 8 Housing Vouchers Program

Audit finding description:

The Municipality coded as "HUD", in the property and equipment subsidiary all units acquired with federal funds of this federal agency and did not segregate in the list of properties purchased with HOME Program funds, Community Development Block Grant (CDBG) and Section 8 Program.

In addition, during our review of the Head Start Property Register we noted various instances in which the register did not include the physical location, the Property Maintenance Sheets were not prepared until we requested them and some properties were not marked with a tag number.

Audit finding status:

The Municipality, with the acquisition of the SAP System, accounts each federal grant with a separate fund number, providing information regarding the specific fund source of the acquisition. As a result, condition was corrected.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FISCAL YEAR ENDED JUNE 30, 2004

<u>Federal Grantor</u>	<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Expenditures</u>
US Department of Agriculture	Rural Loan and Grant Program (EMP 1,640,000 & combined with fund delegation)	10.766	N/A	\$2,263,351
	Rural Loan and Grant Program (EMP 8,000,000)	10.766	N/A	2,221,909
	Weed and Seed	N/A	2002-WS-QX-0131	49,878
	USDA Food Program (Pass-through PR Department of Education)	10.558	N/A	360,449
US Department of Health and Human Services	CSBG Law 105-285	93.569		2,960
	Head Start Program	93.600	03-CH-0263-18	11,346,806
	HOPWA	N/A	N/A	188
	HIV Emergency Relief Project Grant	93.914	H89HA00037-08	1,808,415
	SENDEC	93.575	N/A	621,667
	Self Help Housing Geriatric Elderly Care Program (Pass through PR Department of Family)	N/A	63-05-066-0433568	69,866
US Department of Housing and Urban Development	Public and Indian Housing (Pass-through the Puerto Rico Department of Housing for the administration of public residential)	14.850	03-1978	502,224
	Community Development Block Grant	14.218	B-01-MC-72-0001	5,619,636
	Emergency Shelter Grant	14.231	S-01-MC-72-0005	303,241
	Home Investment Partnership Program	14.239	M-01-MC-72-0203	1,033,543
	Section 8 Housing Choice Vouchers	14.871	RQ-007-V0	3,812,597
	Urban Development Action Grant	14.221	N/A	617,160
US Department of Justice	Community Oriented Policing Services	16.710	2000-UM-WX-1321	550,622
	Edward Byrne Memorial ("Centro de Vida Familiar"-Pass-through the PR Department of Justice)	16.579	N/A	53,707
	Local Law Enforcement (Pass-through the Puerto Rico Department of Justice)	16.582	N/A	101,816
Federal Emergency Management Agency	Disaster Assistance (Pass-through the Office of the Governor of Puerto Rico)	83.516	N/A	180,722
US Department of Commerce - Economic Development Administration (EDA)	Multi-tenant Project	N/A	01-11-02519	386,621
Total Expenditures				\$32,013,421

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended June 30, 2004

NOTE 1 – GENERAL

The accompanying schedule of expenditures of federal awards presents the expenditures, for the fiscal year ended June 30, 2004, of all the federal assisted programs of the Municipality of Caguas.

NOTE 2 – ACCOUNTING BASIS

The schedule was prepared following the modified accrual basis of accounting, which is further explained in note 1 of the basic financial statements of the Municipality of Caguas for the fiscal year ended June 30, 2004.

NOTE 3- SUBRECIPIENTS

During fiscal year 2003-04, the Municipality invested \$1,211,249 in sub-recipients for the realization of healthcare, public service, and community development projects. The following were the entities awarded with federal financial assistance programs:

Federal Program	Entity	Disbursements
HIV Relief Emergency Project Grant	*Centro Clínico Nuevas Actitudes*	\$61,902
	Asociación Familiares y Amigos Pacientes SIDA	122,257
	Fundación de Desarrollo Comunal (FUNDESCO)	17,038
	Voluntarios y Acompañantes con el SIDA	32,450
	Gurabo Community Health Center	278,895
	Hogar CREA	467,029
Subtotal		979,571
Emergency Shelter Grant	<i>Milagros del Amor Corporation</i>	24,333
	<i>*Instituto de Orientación y Terapia Familiar* (INOTEF)</i>	48,812
	Centro Clínico Nuevas Actitudes	7,486
	<i>*Hogar Resurrección*</i>	42,189
	Fundación de Desarrollo Comunal (FUNDESCO)	69,186
Subtotal		192,006
Community Development Block Grant Entitlement	<i>*Instituto de Orientación y Terapia Familiar* (INOTEF)</i>	39,672
Total		\$1,211,249

VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS

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Fax:	(787) 258-1650 (787) 258-6482

Finding 2004-1

Our Department of Finance will continue making the efforts to properly account for the Municipality's capital assets and the non-exchange federal grant transactions. We expect to cover these matters properly for the fiscal year that ends on June 30, 2005.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

FINANCIAL STATEMENTS
(with Independent Auditors' Report Thereon)

FISCAL YEAR ENDED
JUNE 30, 2004

Caguas

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INDEPENDENT AUDITORS' REPORT

Hon. William Miranda Marín
Major
Municipality of Caguas

We have audited the accompanying financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the Municipality of Caguas, Puerto Rico, as of and for the fiscal year ended June 30, 2004, which collectively comprise the Municipality's 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 an opinion on these financial statements based on our audit.

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

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

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The PKF International Association is an association of legally independent firms.



Accountants &
business advisors

Hon. William Miranda Marin
Major
Municipality of Caguas

In accordance with Government Auditing Standards, we have also issued our report dated January 24, 2005 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis, and budgetary comparison information on pages 4 through 13 and 22 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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.



PKF, LP
License No. 22
Expires December 1, 2007

January 24, 2005



To the Citizens and the Municipal Legislature
of the City of Caguas

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Autonomous Municipality of Caguas (herein after the Municipality) provides this Management Discussion and Analysis, to comply with the provisions of Government Accounting Standards Board Statement 34 (GASB 34). This narrative overview and analysis of the Municipality's financial activities is for the fiscal year ending June 30, 2004. Please consider this information in conjunction with the accompanying Transmittal Letter and Basic Financial Statements.

FINANCIAL HIGHLIGHTS

- Financial highlights of the year include the following:
- The City's net assets related to government activities increased by \$37.5 millions or 34% over the prior year. Net assets related to business type activities increased by \$3 millions or 19% over the prior fiscal year.
- The result of activities produces an increase in net assets by \$40.5 millions or 31.3% over the prior year.
- The cost of government activities amounted to \$124 millions and the cost of business type activities were \$1 million, for a cost of \$125 millions for all the City-wide programs and activities.
- The General Fund (the primary operating fund) reflected on a current financial resource basis, reports an increase of \$3.9 millions in fund balance or 24.6% and an increase in unreserved fund balance of \$4.5 millions or 41.3% from year 2003.

- Fiscal year 2004 revenues from General Fund showed a favorable variance of \$7 millions or 9.7% of increase from 2003. Expenditures on the other hand showed an unfavorable variance \$7.4 millions or 10.3% from 2003.

The summaries of these events are mentioned in the following paragraph and explained under the General Fund Budgetary Highlights Section.

FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the Municipality's basic financial statements. The Municipality's basic financial statements include three components: 1) Government-Wide Financial Statements, 2) Fund Financial Statements, and 3) Notes to the Basic Financial Statements. This report also contains additional required supplementary information (budgetary schedules) and other supplementary information (combining financial statement) in addition to the basic financial statements themselves. These components are described below:

Basic Financial Statements

The Government-Wide Financial Statements present the financial picture of the Municipality from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets of the Municipality (including infrastructure) as well as all liabilities (including long-term debt). Additionally, certain eliminations have been made in regards to interfund activity, payables and receivables.

The Fund Financial Statements include statements for two categories of activities—governmental and enterprise. The governmental activities are prepared using the current financial resources measurement focus and modified accrual basis of accounting. The enterprise activities are the same as business-type activities we report in the government-wide statements but provide more detail and additional information such as cash flows, for proprietary funds. Reconciliation of the Fund Financial Statements to the Government-Wide Financial Statements is provided to explain the differences created by the integrated approach.

Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include all assets and liabilities of the Municipality using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Municipality's net assets and changes in them. Net assets are the difference between assets and liabilities, which is one way to measure the Municipality's financial health, or financial position. Over time, increases or decreases in the Municipality's net assets are one indicator of whether its financial health is improving or deteriorating. Other factors to consider are changes in the Municipality's property tax base and the condition of the Municipality's roads.

Governmental activities report all of the Municipality's basic service activities that include general government services, law enforcement, public works and parks, recreation services, and community development services, social services including health costs contributions to the State health reform. Property, volume of business tax, construction permits tax, contribution in lieu of taxes, fines and penalties and other licenses fees, state and federal grants, and interest income finance these activities.

Fund Financial Statements

The Fund financial statements provide detailed information about the major funds — not the Municipality as a whole. Some funds are required to be established by State law and by bond covenants. However, management establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money.

Governmental Funds - Consist of the Municipality's basic services, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the Municipality's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. The differences of results in the governmental fund financial statements to those in the government-wide financial statements are explained in a reconciliation schedule following each governmental fund financial statement.

Proprietary Funds – When the Municipality's charge customers for the services it provides - whether to outside customers or to other units of the City - these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the City's enterprise funds are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds.

Notes

Notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes can be found immediately following the fund financial statements.

Supplementary Information

Required supplementary information follows the basic financial statements and includes budgetary comparison schedules, including also reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund and the Municipality's major special revenue funds as presented in the governmental fund financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As mentioned earlier, the Municipality has prepared the fiscal year ending June 30, 2004 and 2003 financials in the format prescribed by the provisions of Government Accounting Standards Board Statement 34 (GASB 34).

Net Assets

The Municipality's Net Assets for 2004 is as follows:

	Net Assets	
	Governmental Activities	
	<u>2004</u>	<u>2003¹</u>
Current Assets	\$144,783,010	\$116,510,319
Noncurrent assets:		
Capital Assets	<u>148,271,988</u>	<u>114,591,588</u>
Total Assets	<u>293,054,998</u>	<u>231,101,877</u>
Current Liabilities	40,445,724	19,151,011
Long-term Debt	<u>105,485,066</u>	<u>102,303,050</u>
Total Liabilities	<u>145,930,790</u>	<u>121,454,061</u>
Net Assets:		
Invested in Capital Assets, net of debt	42,760,900	20,320,637
Restricted	91,858,123	78,907,104
Unrestricted	<u>12,505,185</u>	<u>10,420,075</u>
Total Net Assets	<u>\$147,124,208</u>	<u>\$109,647,816</u>

The Municipality's net assets total \$147 millions at the end of 2004. The second largest portion of the Municipality's net assets, \$42.76 millions or 29%, reflects its investments in capital assets such as land, buildings, equipment and infrastructure (roads, and other immovable assets), less any related debt used to acquire those assets that is still outstanding. The assets are used to provide services to residents; consequentially, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The largest portion of the Municipality's restricted net assets, \$91.86 millions or 62.5%, represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$12.5 million or 8.5%, may be used to meet the Municipality's ongoing obligations to residents and creditors. Internally imposed designations of resources are not presented as restricted net assets.

¹ 2003 net assets report included both, governmental and business activities under that column.

Changes in Net Assets

The Municipality's Change in Net Assets for fiscal years ended June 30, 2004 and June 30, 2003, is as follows:

Changes in Net Assets

	<u>Governmental Activities</u>	
	<u>2004</u>	<u>2003</u>
Program Revenues:		
Charges for services	4,862,172	-
Operating grants and contributions	45,899,345	25,240,904
Capital grants and contributions	<u>9,467,524</u>	<u>15,816,705</u>
Total program revenues	<u>\$ 60,229,041</u>	<u>\$ 41,057,609</u>
General Revenues:		
Property taxes	47,308,064	43,616,537
Volume of business tax	29,213,224	30,972,297
Licenses and permits	12,161,574	6,930,164
Interest and interest income	663,202	1,546,063
Intergovernmental	12,062,938	9,934,152
Solid waste disposal	-	97,096
Parking lot fees	-	271,033
Rent	-	1,072,921
Miscellaneous	-	237,009
Operating transfers	<u>(300,000)</u>	<u>(410,000)</u>
Total general revenues	<u>\$101,109,002</u>	<u>\$94,292,280</u>
Total Revenues	<u>\$161,338,043</u>	<u>\$135,349,889</u>
Expenses:		
General government	\$ 41,479,793	46,111,744
Public safety	7,645,911	6,564,476
Public works	13,371,867	21,831,843
Culture and recreation	7,842,806	7,298,831
Health and Welfare	11,258,187	18,745,316
Economic and social development	4,414,725	1,044,713
Housing	6,595,290	-
Sanitation and environmental	12,042,473	-
Education	13,794,946	11,592,452
Interest on long-term debt	<u>5,415,653</u>	<u>6,794,412</u>
Total expenses	<u>\$123,861,651</u>	<u>\$119,983,787</u>
Increase (decrease) in net assets	<u>\$ 37,476,392</u>	<u>\$ 15,366,102</u>

As mentioned earlier, the Municipality's net assets increased by \$37.5 millions. Most of the Municipality's general service programs are supported by General Revenues that represent \$101 millions or 63% of total Municipality-wide revenues. The increase in property taxes of \$3.7 millions consists of a tax incentive initiative at the bottom of fiscal year 2004. The increase of \$5.2 millions in licenses and permits consists primarily of a strengthening of the construction audit programs. The decrease in volume of business tax (patentes) is due to the application of GASB Statement No. 33, Accounting and Financial Reporting of Non-exchange transactions.

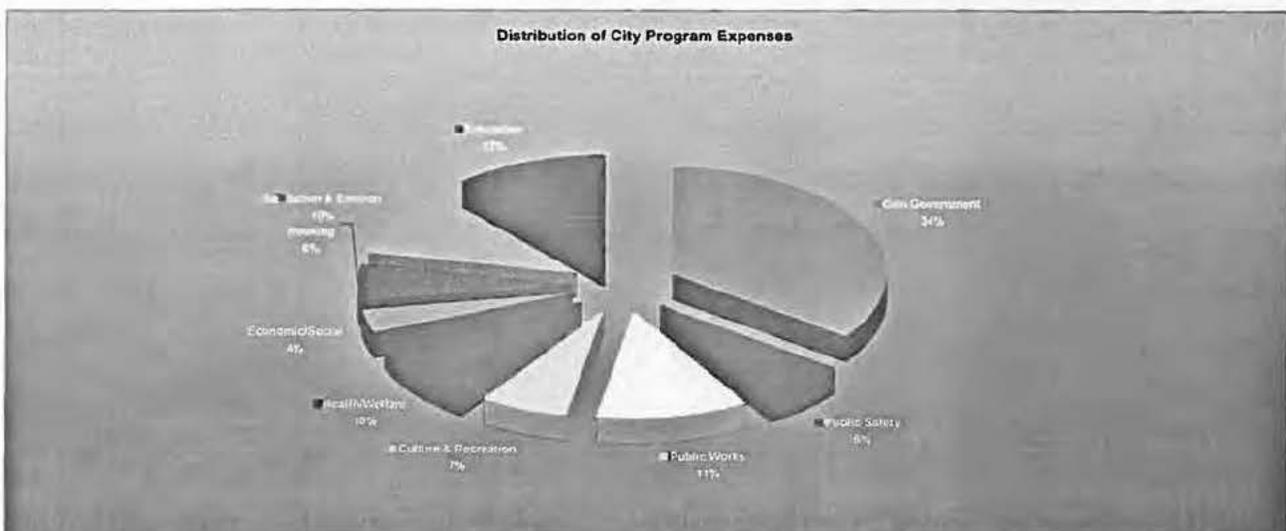
Additional changes include:

- Capital and operating grants increased in 2004 by \$14.3 millions from prior year considering a reclassification of activities previously stated as general revenues. These revenues support the funding of the Municipality's capital improvement projects and some direct services to the citizenship;
- Decline in interest earnings and money invested by \$882,861;
- Charges for service revenues represent .3% of total revenues and are used to support programs recreation and community services, and economic development services.

The total cost of all Municipality programs totals \$124 millions, an increase of \$2.3 million or 1.9%. Changes to Municipality program expenses reflect the following major highlights:

- \$4.63 millions decrease in general services;
- \$8.46 millions decrease for public works services;
- \$3.37 millions increase for culture and recreation;
- \$7.5 millions decrease in health and welfare, but principally because of a reclassification of expenses;
- \$2.2 millions increase in education programs;

The following chart represents the distribution of all Municipality programs expenses:



THE MUNICIPALITY'S FUNDS

The Municipality's General Fund reported an increase in unreserved fund balance of \$4.4 millions due primarily to increases of \$3.1 and \$5.65 millions of property taxes and licenses and permits (construction taxes), respectively, and a reduction of \$4.8 millions volume of business taxes due to implementation of GASB 33. Although expenditures result in an increase of \$7.4 millions of governmental fund, including capital outlays, amounts spent for these capital projects are reported as capital assets in the government-wide Statement of Net Assets. That amount was absorbed with \$7 millions of additional revenues and a transfer of property taxes of \$7.7 millions from the debt service fund. The operating results and changes in fund balances of all the Municipality's other funds were consistent with those discussed earlier for the Municipality's governmental activities.

GENERAL FUND BUDGETARY HIGHLIGHTS

Changes from the Municipality's original budget to the final budget are detailed in the Required Supplementary Information Section along with a comparison to actual activity for the year ended June 30, 2004. Highlights of significant changes from the Municipality's original budget to the final budget include:

Revenues

Over the course of the year, the Municipal Legislature revised the budget several times. These budget amendments consisted primarily of cash surplus resulted from unreserved fund balance in the amount of \$9,705,300 from year ended June 30, 2003.

Expenses and Transfers

During the Municipality's fiscal year, amendments to the original budget were revised to primarily reflect:

- Economic Development: \$991,800; Public Works: \$5,260,500; Cultural and Recreational: \$535,000; Environmental Services: \$100,000; Appropriations for General Government: \$2,121,000; Public Safety: \$447,000; and Community Social Services: \$250,000, for a total of \$9,705,300.
- \$7.7 million operating transfers from surplus in the debt redemption fund to supplement the Municipality's 4-year Capital Improvement Program for projects relating to infrastructure, community services, facilities, and parks and trails.

Concept	Municipal Legislative Resolution					No.
	03B-10	03B-29	04A-35	04A-65	04A-49	Totals
Econ. Development	\$ 756,000	\$ 200,000	\$ 35,800	-	-	\$ 991,800
Public works	2,230,000	850,000	1,554,000	\$402,439	\$224,061	5,260,500
Culture/Recreation	415,000	120,000	-	-	-	535,000
Environment	100,000	-	-	-	-	100,000
General Government	400,000	908,000	765,000	48,000	-	2,121,000
Public safety	67,000	-	340,000	40,000	-	447,000
Community/Social	-	-	250,000	-	-	250,000
	\$3,968,000	\$2,078,000	\$2,944,800	\$490,439	\$224,061	9,705,300

CAPITAL ASSETS

As of June 30, 2004, the Municipality had \$238.57 millions invested in a variety of capital assets, as reflected in the following schedule. This amount represents an increase of \$42.8 millions or 22% above the prior year amount after considering the retroactive adjustment of infrastructure assets on the application of the GASB Statement 34.

Capital Assets at Year-end

	Primary Government Activities
Land and improvement	\$27,549,004
Buildings and Structures	13,310,629
Machinery and Equipment	26,089,803
Facilities	86,213,541
Infrastructure	39,041,426
Works of art and historical treasures	2,313,811
Computer software	725,989
Construction in Progress	43,326,740
Totals	<u>\$238,570,943</u>

The following reconciliation summarizes the change in Capital Assets, which primarily reflects the addition of Construction in Progress for various public works and the beginning phases for various Public Works Capital Improvement Projects (CIP's) as part of the Municipality's new multiple-year 4-year CIP budget program and the inclusion of depreciation.

Changes in Capital Assets
(in Millions)

	<i>Audited</i>				<i>Audited</i>
	6/30/03	Additions	Deletions	Transfers	6/30/04
Building	13.1	-	-	.22	\$ 13.33
Facilities	84.7	-	-	1.53	86.22
Construction in progress	7.7	38.80	-	(3.22)	43.33
Machinery and equipment	24.7	1.60	.26	-	26.09
Software developed	-	.73	-	-	.73
Works of arts	2.3	.06	-	-	2.31
Infrastructure	37.6	-	-	1.47	39.04
Land	25.5	2.0	-	-	27.54
	\$ 195.5	17.1	.26	-	238.58
Accumulated depreciation					(90.30)
Ending balance					\$ 148.28

This year major additions to Capital Assets included:

Construction of a new bridge at Las Carolinas community	\$ 531,703
Improvements to Muñoz Marin Avenue	1,202,961
Jardín Botánico development	587,869
Restoration of Barriada Morales Community	1,040,728
Betterments to Fine Arts Center	161,105
Restoration of properties at Urban Center	502,883
Improvements to various water supply systems at rural locations	2,952,211
Rural roads improvements	2,639,300
General facilities improvements	852,004
Improvements of Solá Morales Baseball Park	666,728
Honor al Río development	113,759
	<u>\$ 11,251,251</u>

DEBT ADMINISTRATION

<i>Outstanding Debt, at year-end</i>	Governmental Activities
General Obligation Bonds	\$ 75,404,197
Special Obligation Bonds	18,861,891
Federal Loans and Notes	11,245,000
Compensated Absences	7,265,764
Total	<u>\$ 112,776,852</u>

The current portions of long-term debt for 2004 are classified as current liabilities in the Municipality's Statement of Net Assets.

Further information on the Municipality's outstanding debt can be found in the notes to the financial statements.

ECONOMIC OUTLOOK AND MAJOR INITIATIVES

Property tax revenue, without considering the effects of the tax incentives, remains almost the same. However, property tax revenues considered with the effect of the municipal lottery and subsidy increased only by .2%. Assessed valuation also decreased by .4% during FY 2004.

Although low interest rates has spur homeowners to refinancing, housing developments and local demand, benefited with limitation on developments and higher cost of land at the San Juan metropolitan area had helped sales of new developments in the City an a moderate growing rate as well as the property tax valuations.

REQUEST FOR FINANCIAL INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of Caguas residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Caguas, Office of the Mayor, P.O. Box 907, Caguas, Puerto Rico, 00726-0907.

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Net Assets
June 30, 2004

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 69,749,888	\$ 3,866,336	\$ 73,616,224
Cash with fiscal agent	12,342,237	-	12,342,237
Volume of business tax receivable	13,813,454	-	13,813,454
Other licenses and permits receivables	1,885,853	-	1,885,853
Intergovernmental receivables	7,339,664	815,000	8,154,664
Federal grant receivables	35,811,954	1,900,000	37,711,954
Internal balances	1,230,218	(1,230,218)	-
Rent and other services charge receivables	2,609,742	131,911	2,741,653
Total current assets	<u>144,783,010</u>	<u>5,483,029</u>	<u>150,266,039</u>
Noncurrent assets:			
Capital assets, net	148,271,988	18,762,947	167,034,935
Loan receivable, net	<u>-</u>	<u>2,617,269</u>	<u>2,617,269</u>
Total noncurrent assets	<u>148,271,988</u>	<u>21,380,216</u>	<u>169,652,204</u>
Total assets	<u>\$ 293,054,998</u>	<u>\$ 26,863,245</u>	<u>\$ 319,918,243</u>

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Net Assets (continued)
June 30, 2004

	Governmental Activities	Business-Type Activities	Total
LIABILITIES			
Current liabilities:			
Bonds and notes payable, current	6,288,033	182,610	6,470,643
Accounts payable and accrued liabilities	29,946,336	2,345,795	32,292,131
Accrued compensated absences, current	1,453,153	-	1,453,153
Due to other governments	1,191,764	-	1,191,764
Advance deposits	1,079,425	-	1,079,425
Other deferred	487,013	-	487,013
Total current liabilities	40,445,724	2,528,405	42,974,129
Noncurrent liabilities:			
Bonds and notes payable, noncurrent	99,223,055	5,444,105	104,667,160
Accrued legal claims	449,400	-	449,400
Accrued compensated absences	5,812,611	-	5,812,611
Total noncurrent liabilities	105,485,066	5,444,105	110,929,171
Total liabilities	145,930,790	7,972,510	153,903,300
Net assets:			
Invested in capital assets, net of related debt	42,760,900	8,529,687	51,290,587
Restricted for:			
Housing programs	15,681,035	-	15,681,035
Youth and children programs	11,485,068	-	11,485,068
Capital projects	22,105,345	-	22,105,345
Debt service	12,285,535	-	12,285,535
Other special purposes	30,301,140	-	30,301,140
Unrestricted	12,505,185	10,361,048	22,866,233
Total net assets	147,124,208	18,890,735	166,014,943
Total liabilities and net assets	\$ 293,054,998	\$ 26,863,245	\$ 319,918,243

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Net Assets (continued)
June 30, 2004

Fund balance per Fund Statements	\$ 90,418,330
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and not reported in the funds.	148,271,988
Other long term liabilities, such as accrued compensated absences, litigations and other contingencies are not available to pay for current year expenditures and therefore not reported in the funds	(7,715,164)
Other economic resources not available to pay current year expenditures, but collectible after the period of availability, are not reported in the funds.	21,660,142
General obligation bonds, special and federal loans are not due and payable in the current period and therefore not reported in the funds.	(105,511,088)
Net assets of governmental activities	<u>\$ 147,124,208</u>

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Activities
For the Fiscal Year Ended June 30, 2004

<u>Functions and Programs</u>	<u>Expenses</u>	<u>Charges for services</u>	<u>Operating grants and contributions</u>	<u>Capital grants and contributions</u>	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Totals</u>
Governmental activities:							
General government	\$ 41,479,793	\$ 3,843,880	\$ -	\$ -	\$ (37,635,913)	\$ -	\$ (37,635,913)
Public safety	7,645,911	978,319	798,517	-	(5,869,075)	-	(5,869,075)
Public works	13,371,867	-	3,272,957	4,873,240	(5,225,670)	-	(5,225,670)
Culture and recreation	7,842,806	-	1,761,280	-	(6,081,526)	-	(6,081,526)
Health and welfare	11,258,187	-	6,226,689	-	(5,031,498)	-	(5,031,498)
Economic and social development	4,414,725	-	5,585,711	4,594,284	5,765,270	-	5,765,270
Housing	6,595,290	-	10,101,682	-	3,506,392	-	3,506,392
Sanitation and environmental	12,042,473	39,973	-	-	(12,002,500)	-	(12,002,500)
Education	13,794,946	-	18,152,509	-	4,357,563	-	4,357,563
Debt service payments	5,415,653	-	-	-	(5,415,653)	-	(5,415,653)
Total governmental activities	123,861,651	4,862,172	45,899,345	9,467,524	(63,632,610)	-	(63,632,610)
Business-type activities:							
Fine Arts Center	599,417	503,908	-	2,715,000	-	2,619,491	2,619,491
Community Development Bank	216,075	158,637	84,835	-	-	27,397	27,397
Multitenant	80,893	302,164	-	-	-	221,271	221,271
Turabo Recreational Park	148,879	-	-	-	-	(148,879)	(148,879)
Total Business-type activities	1,045,264	964,709	84,835	2,715,000	-	2,719,280	2,719,280
General revenues:							
Property taxes					47,308,064	-	47,308,064
Volume of business tax					29,213,224	-	29,213,224
License, and permits					12,161,574	-	12,161,574
Interest and investment income					663,202	37,648	700,850
Intergovernmental					12,062,938	-	12,062,938
Miscellaneous					-	2,596	2,596
Operating transfers					(300,000)	300,000	-
Total general revenues					101,109,002	340,244	101,449,246
Change in net assets					37,476,392	3,059,524	40,535,916
Net assets - beginning (as previously reported)					109,647,816	17,478,103	127,125,919
Prior period adjustments					-	(1,646,892)	(1,646,892)
Net assets - beginning (as restated)					109,647,816	15,831,211	125,479,027
Net assets - ending					\$ 147,124,208	\$ 18,890,735	\$ 166,014,943

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Governmental Fund Financial Statements
 Combined Balance Sheet
 June 30, 2004

	General	Housing Rental Program	Public Residential Administration	Head Start Youth and Children Programs	Capital Projects	Debt Service	Legislative	Other Special Revenue	Totals
Assets									
Cash and investments	\$ 13,081,890	\$ 2,095,932	\$ 599,204	\$ 803,157	\$ 48,596,416	\$ -	\$ 1,722,610	\$ 2,850,679	\$ 69,749,888
Cash with fiscal agent	-	-	-	-	-	12,342,237	-	-	12,342,237
Municipal license taxes receivable	13,813,454	-	-	-	-	-	-	-	13,813,454
Other licences and permits receivable	1,885,853	-	-	-	-	-	-	-	1,885,853
Intergovernmental receivables	910,790	-	-	-	-	-	6,428,874	-	7,339,664
Federal grants receivables	-	11,580,981	399,007	10,809,734	2,558,957	-	-	10,463,275	35,811,954
Due from other funds	21,534,856	1,093,805	-	9,980,878	2,940,310	-	48,149	214,517	35,812,515
Rent receivables	321,719	-	-	-	-	-	-	1,812	323,531
Other receivables	2,286,211	-	-	-	-	-	-	-	2,286,211
Total assets	\$ 53,834,773	\$ 14,770,718	\$ 998,211	\$ 21,593,769	\$ 54,095,683	\$ 12,342,237	\$ 8,199,633	\$ 13,530,283	\$ 179,365,307

MUNICIPALITY OF CAGUAS, PUERTO RICO

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Governmental Fund Financial Statements
Combined Balance Sheet (continued)

June 30, 2004

	General	Housing Rental Program	Public Residential Administration	Head Start Youth and Children Programs	Capital Projects	Debt Service	Legislative	Other Special Revenue	Totals
<u>Liabilities and other credits</u>									
Accounts payable and accrued liabilities									
	\$ 4,339,438	\$ -	\$ -	\$ 1,253,575	\$ 23,084,028	\$ 200	\$ 676,683	\$ 1,745,338	\$ 31,099,262
Due to other governments	1,191,764	-	-	-	-	-	-	-	1,191,764
Due to other funds	15,206,269	81,298	6,596	20,967	8,906,310	56,502	6,864,717	3,439,638	34,582,297
Deferred volume of business taxes	11,673,057	-	-	-	-	-	-	-	11,673,057
Deferred federal grant revenues	-	-	-	8,834,159	-	-	-	-	8,834,159
Advanced deposits	1,079,425	-	-	-	-	-	-	-	1,079,425
Other deferred revenues	419,839	-	-	-	-	-	-	67,174	487,013
Total liabilities and other credits	33,909,792	81,298	6,596	10,108,701	31,990,338	56,702	7,541,400	5,252,150	88,946,977
<u>Fund Equity</u>									
Fund balances									
Reserved for encumbrances	4,723,377	-	-	-	-	-	-	-	4,723,377
Reserved for housing programs	-	14,689,420	991,615	-	-	-	-	-	15,681,035
Reserved for youth and children programs	-	-	-	11,485,068	-	-	658,233	8,278,133	20,421,434
Reserved for debt service	-	-	-	-	-	12,285,535	-	-	12,285,535
Reserved for capital projects	-	-	-	-	22,105,345	-	-	-	22,105,345
Unreserved	15,201,604	-	-	-	-	-	-	-	15,201,604
Total fund balances	19,924,981	14,689,420	991,615	11,485,068	22,105,345	12,285,535	658,233	8,278,133	90,418,330
Commitments and contingencies	-	-	-	-	-	-	-	-	-
Total liabilities and fund equity	\$ 53,834,773	\$ 14,770,718	\$ 998,211	\$ 21,593,769	\$ 54,095,683	\$ 12,342,237	\$ 8,199,633	\$ 13,530,283	\$ 179,365,307

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

 Governmental Fund Financial Statements
 Combined Statement of Revenues, Expenditures and Changes in Fund Balances-
 For the Fiscal Year Ended June 30, 2004

	General	Housing Rental Program	Public Residential Administration	Head Start Youth and Children Programs	Capital Projects	Debt Service	Legislative	Other Special Revenue	Totals
Revenues :									
Property taxes	\$ 34,198,539	\$ -	\$ -	\$ -	\$ -	\$ 13,109,525	\$ -	\$ -	\$ 47,308,064
Volume of business taxes	17,540,168	-	-	-	-	-	-	-	17,540,168
Licenses and permits	12,147,648	-	-	-	13,926	-	-	-	12,161,574
Federal grants	-	7,893,807	726,753	15,054,541	4,873,240	-	-	3,968,408	32,516,749
Fines and penalties	978,319	-	-	-	-	-	-	-	978,319
Interest and investment income	504,671	7,617	-	61	64,060	-	1,298	85,495	663,202
Intergovernmental	11,219,323	-	-	-	7,026,050	-	5,461,585	375,400	24,082,358
Solid waste disposal	37,445	-	-	-	-	-	-	2,528	39,973
Parking lot fees	286,167	-	-	-	-	-	-	235,662	521,829
Rent	527,728	-	-	-	17,435	-	-	19,604	664,767
Other	1948,619	-	-	-	-	-	-	708,665	2,657,284
Total revenues	79,388,627	7,901,424	726,753	15,054,802	12,094,711	13,109,525	5,462,883	5,395,762	139,134,287
Expenditures									
General government	35,662,224	-	-	-	-	-	-	141,490	37,073,714
Public safety	6,330,626	-	-	-	-	-	-	706,302	7,036,928
Public works	8,312,998	-	-	-	3,693,669	-	150,327	139,828	12,306,822
Culture and recreation	6,411,243	-	-	-	449,540	-	24,859	332,499	7,218,141
Health and welfare	3,905,310	-	-	130,1547	6,356	-	2,700,320	2,447,960	10,361,493
Economic and social development	3,522,932	-	-	-	18,1026	-	-	359,142	4,081,100
Housing	539,617	4,907,773	481,217	-	1,333	-	2,458	137,591	6,069,987
Sanitation and environmental	10,964,747	-	-	-	-	-	-	39,713	11,004,460
Education	1,580,303	-	-	10,454,396	-	-	-	66,1504	12,696,203
Capital outlays	2,484,717	34,537	21,007	578,209	3,1478,171	-	2,649,366	6,045,758	43,289,765
Debt service payments	-	-	-	-	-	-	-	-	-
Principal	-	-	-	-	-	6,039,422	-	-	6,039,422
Interest	-	-	-	-	-	5,415,663	-	-	5,415,663
Total expenditures	79,714,717	4,942,310	502,224	12,334,152	35,808,095	11,455,085	5,537,328	12,281,787	132,575,698
Other financing sources (uses)									
Proceeds from debt issuance	-	-	-	-	15,420,000	-	-	-	15,420,000
Transfer in (out) interest	134,348	-	-	-	-	(134,348)	-	-	-
Transfer in (out) property taxes	7,700,000	-	-	-	-	(7,700,000)	-	-	-
Operating transfer in	3,847,239	-	-	-	370,000	2,252,404	30,095	4,467,288	10,967,026
Operating transfer out	(7,415,914)	-	-	-	-	-	-	(3,873)	(7,419,787)
Other financing sources (uses)	4,265,673	-	-	-	15,790,000	(5,581,944)	30,095	4,463,415	10,967,239
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	3,939,583	2,959,114	224,529	2,720,450	(7,923,384)	(3,927,504)	(44,350)	(2,422,610)	(4,474,172)
Fund balances at beginning of year (as previously reported)	15,985,398	4,784,642	-	4,780,004	19,048,405	16,213,039	-	34,081,014	94,892,502
Prior period adjustment	-	6,945,664	767,086	3,984,614	10,980,324	-	702,583	(23,380,271)	-
Fund balances at beginning of year (as restated)	15,985,398	11,730,306	767,086	8,764,618	30,028,729	16,213,039	702,583	10,700,743	94,892,502
Fund balances at end of year	\$ 19,924,981	\$ 14,689,420	\$ 991,615	\$ 11,485,068	\$ 22,105,345	\$ 12,285,535	\$ 658,233	\$ 8,278,133	\$ 90,418,330

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Fiscal Year Ended June 30, 2004

Net change in fund balance - total governmental funds	\$ (4,474,172)
Amounts reported in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	33,776,903
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	18,790,875
General long term debt proceeds provide current financial resources to governmental funds, but issuing debt increases long term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets. This is the amount by which proceeds exceed or are below the repayments	(9,380,578)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.	<u>(1,236,636)</u>
Change in net assets of governmental activities	<u>\$ 37,476,392</u>

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Revenues and Expenditures
 Budget and Actual- General Fund
 Non GAAP Budgetary Basis
 Year Ended June 30, 2004

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual amounts in the budgetary basis</u>	<u>Variance Favorable (Unfavorable)</u>
Resources:				
Property taxes	\$ 33,055,223	\$ 33,055,223	\$ 34,198,539	\$ 1,143,316
Volume of business taxes	21,525,000	21,525,000	17,540,168	(3,984,832)
Licenses and permits	5,126,000	5,126,000	12,147,648	7,021,648
Fines and penalties	480,000	480,000	978,319	498,319
Interest and investment income	1,400,000	1,400,000	504,671	(895,329)
Intergovernmental	7,909,534	7,909,534	11,219,323	3,309,789
Solid waste disposal	94,890	94,890	37,445	(57,445)
Parking lot fees	443,719	443,719	286,167	(157,552)
Rent	303,618	303,618	527,728	224,110
City Council Resolutions	-	9,705,300	9,705,300	-
Other service charges	1,695,544	1,695,544	1,948,619	253,075
Other revenue sources	-	-	7,834,348	7,834,348
Transfer-in	5,907,939	5,907,939	3,847,239	(2,060,700)
Amounts available for appropriation	<u>\$ 77,941,467</u>	<u>\$ 87,646,767</u>	<u>\$ 100,775,514</u>	<u>\$ 13,128,747</u>
Expenditures charged to appropriations:				
Culture and recreation	7,170,311	7,062,239	6,816,127	246,112
Economic and social development	5,379,709	3,594,558	3,568,553	26,005
Education	1,724,718	1,699,832	1,670,936	28,896
General government	27,028,534	33,372,560	32,242,036	1,130,524
Capital outlays	-	1,091,421	1,005,158	86,263
Health and welfare	5,023,249	4,151,892	4,077,940	73,952
Housing	582,071	684,112	679,349	4,763
Sanitation and environmental	7,995,357	11,751,597	11,737,074	14,523
Public safety	6,386,676	6,253,363	6,378,457	(125,094)
Public works	8,564,462	9,898,813	8,977,907	920,906
Transfer out	8,086,380	8,086,380	7,415,914	670,466
Total charges to appropriations	<u>77,941,467</u>	<u>87,646,767</u>	<u>84,569,451</u>	<u>3,077,316</u>
Excess of resources over appropriations	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 16,206,063</u>	<u>\$ 16,206,063</u>

See notes to the financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Net Assets
Proprietary Funds
June 30, 2004

	Fine Arts Center	Community Development Bank	Multitenant Funds	Turabo Recreation Park	Totals
Assets					
Current Assets:					
Cash and cash equivalents	\$ 1,023,987	\$ 1,904,966	\$ 937,383	\$ -	\$ 3,866,336
Due from other funds	928,610	-	-	-	928,610
Accounts receivable	81,713	8,941	41,257	-	131,911
Due from federal agency	-	-	1,900,000	-	1,900,000
Due from other governments	-	-	815,000	-	815,000
Total current assets	2,034,310	1,913,907	3,693,640	-	7,641,857
Noncurrent Assets:					
Loans receivable, net	-	2,617,269	-	-	2,617,269
Capital assets:					
Land	-	-	1,071,654	-	1,071,654
Building and improvements	7,255,257	-	3,256,493	7,445,823	17,957,573
Equipment	200,748	33,303	-	2,394	236,445
Less: Accumulated depreciation	(1,013,714)	(25,255)	(285,767)	(2,214,958)	(3,539,694)
Construction in progress	3,017,455	-	19,514	-	3,036,969
Capital assets net	9,459,746	8,048	4,061,894	5,233,259	18,762,947
Total non-current assets	9,459,746	2,625,317	4,061,894	5,233,259	21,380,216
Total assets	\$ 11,494,056	\$ 4,539,224	\$ 7,755,534	\$ 5,233,259	\$ 29,022,073

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Net Assets (continued)

Proprietary Funds

June 30, 2004

	Fine Arts Center	Community Development Bank	Multitenant Funds	Turabo Recreation Park	Totals
Liabilities					
Current liabilities					
Notes payable (current portion)	\$ 100,000	\$ 82,610	\$ -	\$ -	\$ 182,610
Due to other fund	138,945	1,418,524	601,359	-	2,158,828
Accounts payable and accrued liabilities	1,282,019	40,754	1,023,022	-	2,345,795
Total current liabilities	1,520,964	1,541,888	1,624,381	-	4,687,233
Noncurrent liabilities:					
Notes payable (non-current portion)	4,900,000	544,105	-	-	5,444,105
Total liabilities	6,420,964	2,085,993	1,624,381	-	10,131,338
Net assets					
Investment in capital assets (net of related debt)	4,459,745	8,048	4,061,894	-	8,529,687
Unrestricted	613,347	2,445,183	2,069,259	5,233,259	10,361,048
Total net assets	5,073,092	2,453,231	6,131,153	5,233,259	18,890,735
Commitments and contingencies	-	-	-	-	-
Total liabilities and net assets	\$ 11,494,056	\$ 4,539,224	\$ 7,755,534	\$ 5,233,259	\$ 29,022,073

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Revenues, Expenses and Changes in Net Assets
 Proprietary Funds
 For the Fiscal Year Ended June 30, 2004

	Fine Arts Center	Community Development Bank	Multitenant Funds	Turabo Recreation Park	Totals
Operating revenues:					
Charges for services and rents	\$ 503,908	\$ -	\$ 302,164	\$ -	\$ 806,072
Interest on loans	-	158,637	-	-	158,637
Other	-	2,596	-	-	2,596
Total operating revenue	503,908	161,233	302,164	-	967,305
Operating expenses:					
Payroll	-	87,942	-	-	87,942
Depreciation	165,272	9,421	63,073	148,879	386,645
Professional fees	81,225	55,200	-	-	136,425
Bank service charges	-	2,997	-	-	2,997
Dues and memberships	-	880	-	-	880
Other miscellaneous	-	19,288	-	-	19,288
Repairs and maintenance	35,476	-	17,820	-	53,296
Office supplies	283	3,878	-	-	4,161
Rent	-	16,800	-	-	16,800
Utilities	-	6,000	-	-	6,000
Total operating expenses	282,256	202,406	80,893	148,879	714,434
Income (loss) before contributions and transfers	221,652	(41,173)	221,271	(148,879)	252,871
Non-operating revenues (expenses)					
Interest income	15,535	6,154	15,959	-	37,648
Interest expense	(317,161)	(13,669)	-	-	(330,830)
Total non-operating revenues (expenses)	(301,626)	(7,515)	15,959	-	(293,182)
Income (loss) before contributions and transfers	(79,974)	(48,688)	237,230	(148,879)	(40,311)
Contributions and transfers:					
Federal grants	-	84,835	1,900,000	-	1,984,835
Legislative contributions	-	-	815,000	-	815,000
Transfer from governmental funds	-	-	300,000	-	300,000
Total contributions and transfers	-	84,835	3,015,000	-	3,099,835
Changes in net assets	(79,974)	36,147	3,252,230	(148,879)	3,059,524
Net assets at beginning of fiscal year:					
As previously reported	5,153,066	2,417,084	4,525,815	5,382,138	17,478,103
Prior period adjustment	-	-	(1,646,892)	-	(1,646,892)
As restated	5,153,066	2,417,084	2,878,923	5,382,138	15,831,211
Net assets at end of fiscal year	\$ 5,073,092	\$ 2,453,231	\$ 6,131,153	\$ 5,233,259	\$ 18,890,735

See notes to financial statements

MUNICIPALITY OF CAGUAS, PUERTO RICO

Statement of Cash-Flows
Proprietary Funds
June 30, 2004

	Fine Arts Center	Community Development Bank	Multitenant Funds	Turabo Recreation Park	Totals
Cash flows from operating activities:					
Receipts from customers	\$ 834,539	\$ -	\$ 306,066	\$ -	1,140,605
Principal collections of loans	-	142,732	-	-	142,732
Rent collected in advance	-	-	-	-	-
Payments to suppliers	(116,984)	(211,639)	(17,820)	-	(346,443)
Loans disbursed	-	(335,500)	-	-	(335,500)
Payments to employees	-	(87,942)	-	-	(87,942)
Net cash provided by (used in) operating activities	717,555	(492,349)	288,246	-	513,452
Cash flows from capital and related financing activities:					
Capital assets investments	(39,744)	-	(1,005,514)	-	(1,045,258)
Principal paid on capital debt	(95,000)	-	-	-	(95,000)
Interest paid on capital debt	(317,161)	-	-	-	(317,161)
Transfer from governmental funds	-	-	-	-	-
Net cash provided by (used in) capital and financing activities	(451,905)	-	(1,005,514)	-	(1,457,419)
Cash flows from non-capital financing activities:					
Principal payments on note payable	-	(94,034)	-	-	(94,034)
Interest expense	-	(13,669)	-	-	(13,669)
Federal grants	-	84,835	-	-	84,835
Loan from other fund	-	1,418,105	-	-	1,418,105
Transfer from governmental funds	-	-	300,000	-	300,000
Net cash provide by (used in) non capital financing activities	-	1,395,237	300,000	-	1,695,237
Cash flows from investing activities:					
Interest income	15,535	6,154	15,959	-	37,648
Net increase (decrease) in cash	281,185	909,042	(401,309)	-	788,918
Cash at beginning fiscal year	742,802	995,924	1,338,692	-	3,077,418
Cash at end fiscal year	\$ 1,023,987	\$ 1,904,966	\$ 937,383	\$ -	\$ 3,866,336
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:					
Adjustments to reconcile operating income (loss) to net cash provided in (used) in operating activities:					
Operating income (loss)	\$ 221,652	\$ (41,173)	\$ 221,271	\$ (148,879)	\$ 252,871
Depreciation	165,272	9,421	63,073	148,879	386,645
(increase) decrease in loans and accounts receivable	81,713	(1,177,466)	-	-	(1,095,753)
Increase in accounts payable	248,918	716,869	3,902	-	969,689
Net cash provided by (used in) operating activities	\$ 717,555	\$ (492,349)	\$ 288,246	\$ -	\$ 513,452

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

Note 1 - Organization and summary of significant accounting policies

The Municipality of Caguas (the Municipality), founded in 1894, is a municipality of the Commonwealth of Puerto Rico. It is governed by a Major and a 16 member Municipal Assembly elected for a four-year term. The Municipality provides services to its residents in the areas of health, public works, education, public safety, urban development, economic development, culture and recreation, and other services.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The following is a summary of significant accounting policies:

A. Financial reporting entity

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14 of the Governmental Accounting Standards Board (GASB). The basic, but not the only criterion for including a potential component unit within the reporting entity, is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body and if either one of the following conditions exist; the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is 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. Based on the above criteria there are no potential component units, which should be included in the general purpose financial statements.

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. GASB-34 significantly changed the way in which the Municipality reported its finances.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

GASB-34 established two bases for reporting financial information: government-wide financial statements and fund presentation. The government-wide financial statements method adopts the flow of economic resources measurement focus and accrual basis of accounting for both governmental activities and business-type activities. The basis for preparing fund financial statements is similar to conventional governmental financial statements except the focus for presentation is on major funds rather than fund types. Capital assets, including infrastructure assets, and depreciation charges are reported on the entity-wide perspective financial statements. The management's discussion and analysis information precedes the basis financial statements but is considered required supplementary information. Budgetary information is no longer presented in the financial statements but rather is presented as required supplementary information.

The Municipality implemented this statement in fiscal year ended June 30, 2003.

B. Basic Financial Statements GASB Statement No. 34

Government Wide Financial Statements:

The focus of the government wide financial statements is on the overall financial position and activities of the Municipality as a whole. The government wide financial statements will provide with the following:

- Present financial information about the overall government without presenting information about the individual funds or fund types.
- Differentiate between the Municipality's governmental activities and business type activities.
- Measure and present all financial balances and activities based on the economic resources measurement focus and the accrual basis of accounting.

The flow of economic resources measurement and accrual accounting are the basis upon which government wide financial statements are prepared. Under the flow of economic resources measurement focus and accrual basis of accounting, revenues are recognized when earned and expenses are incurred when incurred when these activities are related to exchange and exchange like activities. In addition, long-lived assets are capitalized and depreciated over their estimated economic lives.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

The government wide statements include the Statement of Net Assets and the Statement of Activities:

a. Statement of net assets:

Presentation of assets and liabilities – Assets and liabilities should be presented in the statement of net assets based on their relative liquidity. The liquidity of the assets is determined based their ability to be converted in cash and the absence of any restriction that might limit their conversion to cash. The liquidity of liabilities is based on maturity dates or expected payment dates.

Presentation of capital assets – The governmental entity should report all of its capital assets in the statement of net assets, based on their original historical cost. Capital assets that have been donated should be capitalized at their estimated fair value at the date of the receipt.

Presentation of long term liabilities – Long term liabilities include debts such as bonds, notes, and federal loans. In addition, operating liabilities such as compensated absences and claims must be reported in the statement of net assets.

Presentation of component of net assets – Net assets represent the difference between the Municipality's total assets and its total liabilities. The statement of net assets must identify the components of the net assets, namely (a) invested in capital assets, net of related debt; (b) restricted net assets; and (c) unrestricted net assets.

Invested in capital assets, net of related debt is the difference between capital assets (net of accumulated depreciation) and liabilities attributable to the acquisition, construction or improvement of those assets.

Restricted net assets arise if either of the following conditions exists: (a) externally imposed by creditor, grantors, contributors or laws and regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.

Assets that are not classified as invested in capital assets (net of related debt) or restricted are included in the category of unrestricted net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

b. Statement of Activities:

The focus of the statement of activities is on the net cost of the various activities provided by the governmental entity. The difference between the expenses and revenues related to the specific activities, which identifies the extent to which each function of the Municipality draws from the general revenues of the Municipality or is self financing through fees and intergovernmental aids.

Revenues and other financing inflows – A fundamental concept in the presentation of the statement of activities is the identification of resources inflows to the Municipality that are related to specific programs and those that are general in nature. Revenues are divided in program revenues and general revenues.

Program revenues are those that are identified with an specific function, otherwise the revenues would not flow to the Municipality. As established before, program revenues are presented in the statement of activities as a subtraction of related program expenses in order to identify the net cost or benefit of a particular program. Program revenues are divided in charges for services, operating grants and contributions and capital grants.

General revenues – General revenues included resources that are not specifically related with a specific function, but that are used in the operation of the Municipality.

Expenses – The Municipality reports expenses, including depreciation expense by function. Direct expenses are those that are specifically associated with a service, program or department and are clearly identifiable to a particular function.

Generally, the cost (net of estimated salvage value) of capital assets should be depreciated over their estimated useful lives. Depreciation expense is reported as direct expense of the specific functional category with which the related capital asset has relationship.

Fund Financial Statements:

Fund based financial statements are included in order to demonstrate that restrictions imposed by statutes, regulations, or contracts have been followed. The Municipality has the following major funds:

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Governmental funds - These financial statements have a short term emphasis and generally measure and account for cash and other assets that can easily be converted to cash and are used to account for the Municipality's expendable financial resources and the related liabilities. The measurement focus is upon determination of any changes in financial position. The Municipality's major funds are the following:

General fund

The general fund is used to account for all financial transactions, except those required to be accounted for in another fund.

Housing Rental Programs

Account for current financial resources restricted mainly for housing rental programs to low and very low income family units. Resources are funded by the United States Department of Housing and Urban Development through the Section 8 Housing Voucher Program.

Head Start Youth and Children Program

Account for current financial resources restricted for the education of pre-school aged children that are funded by the United States Department of Health and Human Services.

Capital Projects

Capital projects fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds.

Debt service funds

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Legislative funds

The legislative funds account the accumulation of resources approved by the Legislature of the Commonwealth of Puerto Rico designated for the investment of such in special projects related with housing, public works, economic development and others as requested by the Municipality's citizenship.

Public Residential Administration

On March 26, 2003, the Municipality entered into an Intergovernmental Management Agreement with the Puerto Rico Public Housing Administration (PRPHA). The purpose of the Agreement was to designate the Municipality to act as independent contractor for the PRPHA to manage, administer and operate the low income housing project denominated as José Gautier Benítez, under the United States Housing Act of 1937, as amended. The Project is located at State Road No. 1, behind Villa del Carmen Shopping Center, Caguas, Puerto Rico.

As part of the Agreement, the Municipality submits, on the 1st day of February of each year, an Annual Management Plan in which it delineates its proposed budgets for the year and any work to be performed in the Project.

The terms of the Agreement commenced on May 1st, 2003 (effective date) and shall expire at midnight on April 30th, 2005 (original term). The Agreement may be renewed by the PRPHA for additional periods of one year each, but not beyond April 30th, 2007

The Municipality operates the Program using fiscal periods beginning on July 1st and ending June 30th.

Other Special Revenue funds

Current financial resources used to account for the proceeds of specific revenue sources (other than debt service or capital projects) such as federal grants, that are legally restricted to expenditures for specified purposes.

The financial statements of the governmental funds are the following:

Balance sheet – Reports information about the current financial resources (assets, liabilities and fund balances) of each major governmental fund.

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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Statement of revenues, expenditures and changes in fund balance – Reports information about the inflows, outflows and balances of current financial resources of each major governmental fund.

Proprietary funds – Financial statements for proprietary funds are based on the flow of economic resources (measurement focus) and the accrual basis of accounting. They are used to account for activities, which are similar to operations in the private sector. The proprietary fund type consists of enterprise funds.

Enterprise funds

The enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the cost of providing goods and services (including depreciation) be financed or recovered primarily through user charges, or where the Municipality has decided that periodic determination of revenues earned and expenses incurred is appropriate. The Municipality's enterprise funds follows:

Fine Arts Center – Accounts for the economic resources used to cover the costs for offering artistic, cultural and social activities for the benefit of the citizenship.

Community Development Bank – Accounts for the economic resources designated mainly for the approval of loans for economic development, education and emergency in the benefit of the Caguas citizenship.

Turabo Recreational Park - Accounts for the resources used for the future use of the facilities for sport and recreational activities.

Multitenant Funds – Accounts the deposit of rental resources designated for the Municipality's normal operation other than those functions accounted in the general fund.

The financial statements of the proprietary funds are the following:

Statement of net assets or balance sheet – Assets and liabilities are presented in a classified format to distinguish between current and long term assets and liabilities.

Statement of revenues, expenditures and changes in fund net assets – Revenues and expenses are reported by distinguishing between operating and non-operating revenues and expenses.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Statement of cash flows – The primary purpose of the statement of cash flows is to provide relevant information about the cash receipts and disbursements of the Municipality during the fiscal year. The information of the statement of cash flows should help financial report users assess (a) Municipality's ability to generate future et cash flows; (b) ability to meet its obligation as they come due; (c) its needs for external financing; (d) the reasons for differences between operating income and associated cash receipts and disbursements and the effects on the entity's financial position of both its cash and its non cash investing, capital and financing transactions during the period.

Basis of accounting

The basis of accounting determines when the Municipality recognizes revenues and expenditures/expenses and related assets and liabilities.

Governmental fund types follow the modified accrual basis of accounting. Under this basis of accounting, revenues are recorded in the accounting period in which they become susceptible to accrual, that is, when they become both measurable and available. Available is defined as expected to be collected within the current period or soon enough thereafter to be used to pay liabilities of the current period.

In applying the susceptible to accrual concept to governmental revenues, there are essentially two types of revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the Municipality; therefore, revenues are recognized based upon the expenditures incurred. In the other, monies are virtually unrestricted and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria are met.

The Municipality reports deferred revenue on its combined balance sheet. Deferred revenue arises when potential revenue does not meet both the measurable and available criteria for recognition in the current period. Deferred revenue also arises when the Municipality receives resources before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures.

In subsequent periods, when both revenue recognition criteria are met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and revenue is recognized.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Licenses, permits, service charges, fines and forfeits and miscellaneous revenues are recorded as revenues on the cash basis, which includes amounts collected shortly after June 30. Investment income is recorded as revenue when earned. The enterprise fund follows the accrual basis of accounting. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash, except that pension contributions are not recorded in accordance with generally accepted accounting principles.

Expenditures and related liabilities are generally recorded, except as described below, in the accounting period in which the liability is incurred. Expenditures and related liabilities for interest on long-term obligations, are recorded when due, except for interest due July 1st of the following year which is accounted for as paid on June 30. Vacation, sick leave, disallowances and litigation are recorded in the general long-term debt account group.

The general fund subsidizes part of the operations reported in the enterprise fund through operating transfers. The Municipality records operating transfers from the general fund to the enterprise fund to the extent the liabilities reported in the enterprise fund would be liquidated with expendable available financial resources.

D. Budgetary accounting

The Municipality's annual budget is prepared on the budgetary basis of accounting and represents departmental appropriations recommended by the Mayor and approved by the Municipality's City Council prior to the beginning of the fiscal year. Budgetary control is maintained at the department level for each individual appropriation.

Amendments to the budget, and budgetary transfers related to personal expenditures, require the approval of the City Council. Non-capital encumbrances lapse at the end of the next fiscal year.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the general fund in the accompanying Statement of Revenues and Expenditures - Budget and Actual - General Fund is presented on the budgetary basis to enhance comparability.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are considered as expenditures for budgetary purposes.
2. Prior year encumbrances settled during the year and recorded as expenditures for GAAP Basis.
3. Effect of GAAP basis accruals.
4. Effect of City Council resolutions less deferred revenue recognized as revenue during the year.

The following is reconciliation, of the differences between GAAP and the budgetary basis for the general funds excess of expenditures and other financing uses over revenues and other financing sources:

GAAP basis	\$ 3,939,583
Prior year's encumbrances settled during the current fiscal year	6,902,403
Current fiscal year encumbrances treated as current year expenditures for budgetary purposes	(4,341,223)
Municipality Council Resolutions	9,705,300
	\$ 16,206,063

E. Cash, cash equivalents, and investments

Substantially all cash balances are commingled in a general checking account and several special purpose bank accounts, except for cash and investments restricted by law. Each fund records its equity interest in the pooled cash balance. The available cash balance in the general checking account beyond immediate needs is invested in interest-bearing deposits. Investment earnings are all credited to the general fund.

The Municipality of Caguas carried its investments at fair market value. At June 30, 2004 the Municipality had an unrealized gain on investments of approximately \$394,754. Investments are composed of highly liquid U.S. Treasury Securities which are covered by the provisions of GASB Statement No. 31 "Accounting and Financial Reporting for Certain Investments and for External Investment Pools" therefore, the Municipality accounts for changes in the market value of its investments at the closing of the period.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Cash with fiscal agent reports property tax collections retained by the "Centro de Recaudaciones de Ingresos Municipales" (CRIM) and restricted for the payment of the Municipality's debt service.

F. Interfund transactions

The Municipality has the following types of transactions among funds:

Operating transfers - Transfers that are reported when incurred as "Operating transfers in" by the recipient fund and as "Operating transfers out" by the disbursing fund. Transfers from the general fund to the enterprise fund to subsidize operations are recorded as operating transfers.

Receivables and payable - Transactions between funds outstanding at the end of the fiscal year are referred as due to/from other funds. The general fund provides services, at cost, to other funds. The amounts charged to other funds are treated as reductions in expenditures of the general fund.

Eliminations are made in the government wide statements of the amounts reported as inter-fund receivables as well as operating transfers, except for the net residual amounts due between governmental and business-type activities, which are reported as internal balances.

G. Capital assets

Capital assets acquired or constructed are reported as expenditures in the fund that finances the acquisition and are capitalized at cost in the government-wide statements, as part of governmental activities and depreciated over their economic lives. Donated capital assets are reported at estimated fair market value at the date received. Also, certain improvements such as roads, streets, bridges, curbs and gutters sidewalks are capitalized.

The Municipality determined that its capitalization threshold was to capitalize equipment and vehicles of \$50 and over.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

The Municipality established the following useful lives in months:

Facilities and recreational parks	120 to 720
Building and building improvements	60 to 360
Rural streets and roads	nil to 600
Personal property	36 to 180
Software	60 to 72

H. Enterprise fund capital assets

Property and equipment of the enterprise fund are stated at cost. Building depreciation is provided over the estimated useful life 360 months a straight-line basis.

I. Compensated absences

Employees accrue 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. This liability is presented in the government wide financial statements and not in the funds because it will not be funded with available expendable financial resources at June 30, 2004. 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 unpaid sick leave at the then current rate, if the employee has at least 10 years of service with the Municipality. This liability is also presented in the statement of net assets because it will not be funded with available expendable financial resources at June 30, 2004.

Total debt for compensated absences at June 30, 2004 amounts to \$ 7,265,764 representing the Municipality's commitments to fund such compensated absences from future operations.

J. Long-term debt

The liabilities reported in the government-wide statements include the Municipality's general obligation bonds and notes, and other long-term liabilities including vacation, sick leave, and litigation.

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

K. Reserves of fund balance

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

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.

Debt service - Represents fund balance available to finance future debt service payments.

Capital projects - Represent fund balance available to finance future capital outlays and other public works projects.

Legislative - Represents fund balances available to finance projects approved by the Legislature of the Commonwealth of Puerto Rico for housing, culture and recreation, public works, economic development and other activities requested by the Municipality's citizenship.

Head Start Youth and Children programs - Represents fund balances available to finance activities of education and care of the eligible elderly population, mainly through the Head Start, Child Care and Child Care Food federal programs.

Housing projects - Represents fund balances available to finance activities oriented to the housing rent, acquisition, construction and rehabilitation for the Municipality's eligible citizenship.

L. 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. The government wide statements includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Note 2 - Annual revenues

A. Property taxes

The CRIM is responsible for the assessment of all real and personal property located within the Municipality of Caguas and for the levy, administration and collection of the corresponding taxes. The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of assessment.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000. The Department of the Treasury instead of the property taxpayer becomes the source of payment in these cases.

The annual tax rate for fiscal year 2004 is 8.78% for real property and 6.58% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 6.00% and 4.00% respectively, represent the Municipality's basic property tax rate which is appropriated for general purposes and accounted in the general fund. Such amount is deposited by the CRIM in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

The Commonwealth also contributes an annual tax rate of .20% of each of the tax rates due to a discount granted by the state to the taxpayers.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, the Municipality records the revenues related to property taxes, net of the operational expenses allocated by the CRIM to the Municipality, when such revenues are reported by the CRIM. During the fiscal year ended June 30, 2004 the allocated expenses amounted to \$1,152,074.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

The amount receivable or payable arising from the fiscal year end settlement of actual property tax collections versus property tax advances made by the CRIM to the Municipality is not known. Advances of property tax on (a) and (b) above, are recorded as revenues on the General Fund and Debt Service Fund, respectively. These amounts are preliminary and could be subject to changes. Changes will be recorded in the period reported by the CRIM.

B. Municipal license taxes

The Municipality imposes a volume of business tax pursuant to Act No. 82 of August 30, 1991, on all business entities, which operate within the Municipality, which are not exempt from the tax pursuant to the Industrial Incentives Act. The tax is based on gross revenues, as defined by law, computed at the rate of 1.50% for financial institutions and savings and loans associations, and .50% for all other business entities.

The minimum gross revenue to file the Volume of Business Tax Declaration is \$5,000 and the minimum tax payable is \$25. The date to file the Volume of Business Tax Declaration is April 15. The Municipality grants a five percent discount, if the taxes are paid on or before April 15. Otherwise, 50% of taxes payable must be paid within the first 15 days of each semester beginning with the first semester ending December 31.

Since volume of business tax revenues result from assessments imposed by the Municipality on exchange transactions, they meet the definition of derived tax revenues. As a result, the Municipality recognized an account receivable of volume of business taxes to be collected during the next year, based on the period when the exchange transaction on which the tax is imposed occurs, and a revenue, net of estimated uncollectible accounts in the same period that the asset (cash or receivable) is recognized in the same period that the assets are recognized, provided that the underlying exchange transaction has occurred.

Note 3 - Cash, cash equivalents, and investments

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. During the year, the Municipality invested its funds in interest bearing bank accounts, and certificates of deposit.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

There are three categories of credit risk that apply to the Municipality's cash and investments:

1. Insured or collateralized with securities held by the Municipality's or by the Municipality's agent in the Municipality's name.
2. Collateralized with securities held by the pledging financial institution's trust department or the Municipality's agent in the Municipality's name.
3. Uncollateralized.

Balances held in each category are as follows:

	1	Categories 2	3	Bank Balance	Carrying Amount
Cash	\$ 41,522,875	\$ -	\$ 23,239,723	\$ 64,762,598	\$ 61,115,209
U.S. Government Securities	-	-	4,781,247	-	4,781,247
Certificates of Deposits	-	7,719,768	-	-	7,719,768
	<u>\$ 41,522,875</u>	<u>\$ 7,719,768</u>	<u>\$ 28,020,970</u>	<u>\$ 64,762,598</u>	<u>\$ 73,616,224</u>

Deposits at the Government Development Bank for Puerto Rico consist principally for debt service and capital projects. These are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks. Therefore these have been categorized as "Uncollateralized" in the above table.

Note 4 - Intergovernmental receivables and payables

Sources of intergovernmental revenues are primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain quasi public corporations, such as Puerto Rico Electric Power Authority. The amount of contribution in lieu of tax for the year 2003-2004 was \$7,791,579.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, subsidies through legislative appropriations for capital improvements.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Note 5 - Interfund transactions

Due from/to other funds

Interfund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures.

Following is a summary of interfund assets and liabilities as of June 30, 2004:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
	Housing Rental Programs	\$ 81,298
	Public Residential Administration	6,596
	Head Start Youth and Children Program	20,967
	Capital Project	8,906,310
	Debt Service	56,502
	Legislative	6,864,717
	Other Special Revenue	3,439,638
	Fine Arts	138,945
	Community Development Bank	1,418,524
	Multitenant	<u>601,359</u>
General		<u>\$ 21,534,856</u>
<u>Payable Fund</u>	<u>Receivable Fund</u>	<u>Amount</u>
	Housing Rental Programs	\$ 1,093,805
	Head Start Youth an Children Program	9,980,878
	Capital Projects	2,940,310
	Legislative	48,149
	Other Special Revenue	214,517
	Fine Arts Center	<u>928,610</u>
General		<u>\$15,206,269</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Note 6 – Capital assets

	Balance June 30, 2003	Additions	Retirements	Transfers	Balance Junio 30, 2004
Capital assets not being depreciated					
Land and improvements	\$ 25,482,203	\$ 2,066,801	\$ -	\$ -	\$ 27,549,004
Construction in progress	7,701,348	38,842,303	-	(3,216,911)	43,326,740
Works of art and historical treasures	2,253,811	60,000	-	-	2,313,811
Total not being depreciated	<u>35,437,362</u>	<u>40,969,104</u>	<u>-</u>	<u>(3,216,911)</u>	<u>73,189,555</u>
Other capital assets					
Facilities and improvements	\$ 84,688,393	\$ -	\$ -	\$ 1,525,148	\$ 86,213,541
Buildings and improvements	13,090,673	-	-	219,957	13,310,629
Computer software	-	725,989	-	-	725,989
Rural roads and streets	37,569,619	-	-	1,471,807	39,041,426
Equipment and vehicles	24,755,672	1,594,673	(260,542)	-	26,089,803
Total Other capital assets	<u>160,104,357</u>	<u>2,320,662</u>	<u>(260,542)</u>	<u>3,216,911</u>	<u>165,381,388</u>

A summary of the activity of capital assets for governmental activities group follows:

	Balance June 30, 2003	Depreciation Expense	Retirements	Transfers	Balance June 30, 2004
Accumulated depreciation					
Facilities and improvements	\$ 51,385,584	\$ 4,749,918	\$ -	\$ -	\$ 56,135,502
Building and improvements	3,716,065	490,448	-	-	4,206,512
Equipment and vehicles	11,601,350	2,647,767	(186,977)	-	14,062,140
Computer software	-	18,257	-	-	18,257
Rural roads and streets	14,270,071	1,606,473	-	-	15,876,544
	<u>80,973,070</u>	<u>\$ 9,512,862</u>	<u>\$ (186,977)</u>	<u>\$ -</u>	<u>\$ 90,298,955</u>
Capital assets, net	<u>\$ 114,568,649</u>				<u>\$ 148,271,988</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Depreciation expense for capital assets of governmental activities was charged to the following functions as follows:

General government	\$ 3,303,791
Public safety	608,983
Public works	1,065,045
Culture and recreation	624,665
Health and welfare	896,694
Economic and social development	351,625
Housing	525,303
Sanitation and environmental	1,038,013
Education	1,098,743
	<u>\$ 9,512,862</u>

Note 7 – General long – term debt

The legal debt margin of the Municipality is equal to 10% of the total assessment of property located within the Municipality. Total property assessments, based on information reported by the Municipal Revenue Collection Center amounted to approximately \$896,768,204 of which \$517,083,488 and \$379,684,716 are real and personal property, respectively.

Changes in general long – term debt of governmental activities for the fiscal year ended June 30, 2004 are summarized as follows:

	Bonds	Federal Loan and Notes	Special Loans	Totals
Balance at June 30, 2003	\$ 68,676,030	\$ 7,600,000	\$ 19,527,924	\$ 95,803,954
Payments	(4,746,833)	(300,000)	(666,033)	(5,712,866)
New debt issued	11,475,000	3,945,000	-	15,420,000
Balance at June 30, 2004	<u>\$ 75,404,197</u>	<u>\$ 11,245,000</u>	<u>\$ 18,861,891</u>	<u>\$ 105,511,088</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

As of June 30, 2004, debt service requirements for the above long-term debt, are as follows:

<u>Fiscal year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 6,288,033	\$ 6,244,060	\$ 12,532,093
2006	6,092,033	6,390,473	12,482,506
2007	6,524,033	5,287,364	11,811,397
2008	6,361,033	5,020,809	11,381,842
2009	6,722,758	5,128,008	11,850,766
2010-2014	30,538,003	18,611,967	49,149,970
2015-2019	18,855,027	12,034,469	30,889,496
2020-2024	16,310,000	5,340,715	21,650,715
2025-2029	7,820,168	1,036,816	8,856,984
	<u>\$ 105,511,088</u>	<u>\$ 65,094,681</u>	<u>\$ 170,605,769</u>

A. Bonds

General obligation bonds payable as of June 30, 2004 are as follows:

<u>Series</u>	<u>Interest Rate</u>	<u>Payable Through</u>	<u>Original Issue</u>	<u>Balance July 2, 2004</u>
1983	5.00	2008	663,000	172,000
1985	5.00	2010	1,118,000	455,003
1986	6.13	2011	1,870,000	873,000
1986	5.00	2011	283,000	121,000
1988	5.00	2014	85,000	49,000
1990	5.00	2015	580,000	357,000
1990	3.26-6.31	2005	2,395,000	275,000
1990	6.26	2005	6,425,000	755,000
1991	3.26-6.41	2007	4,745,000	1,495,000
1993	5.00-7.71	2013	18,890,000	12,025,000
1995	4.70-8.00	2015	15,955,000	11,610,000
1994	5.63	2018	2,200,000	1,771,167
1996	4.5	2019	776,000	641,027

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Series	Interest Rate	Payable Through	Original Issue	Balance July 2, 2004
1998	4.88	2004	300,000	-
1999	8.00	2106	13,300,000	10,695,000
2000	7.29	2024	3,150,000	2,900,000
2000	7.29	2016	10,350,000	9,190,000
2000	7.29-12.0	2004	1,090,000	-
2002	5.00-7.5	2026	9,845,000	9,380,000
2002	5.00-8.00	2026	125,000	110,000
2002	5.00-8.00	2026	1,360,000	1,290,000
2003	1.65-5%	2028	9,900,000	9,695,000
2004	2.36-6%	2029	1,575,000	1,545,000
Bonds payable				<u>\$75,404,197</u>

B. Federal loans and notes

Sec. 108 loan of \$8,000,000 payable in annual installments fluctuating from \$200,000 to \$600,000 at 7.50% interest rate until 2019 secured by building and adjacent parking facility owned by the Municipality and appraised at an aggregate fair market value of \$11,750,000 .

7,300,000

Sec. 108 loan \$2,240,000, interest from 1.21% to 4.44% payable in annual installments from \$125,000 to \$270,000 until year 2011, secured by public facilities of the Municipality.

1,400,000

Sec. 108 loan \$4,870,000, interest from 1.21% to 3.82% payable in annual installments from \$350,000 to \$500,000, until year 2009, secured by public facilities of the Municipality.

2,545,000

Total federal loans and notes

\$11,245,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

C. Loans

Operational loan of \$2,065,000 payable in annual installments from \$35,000 to \$165,000 with interest fluctuating from 3.65 to 6.67% until 2027, secured by the Municipality.	\$ 2,030,000
Operational loan of \$2,350,000 payable in annual installments from \$270,000 to \$400,000 with interest of 5.5% until 2009, secured by the Municipality.	1,785,000
Operational loan of \$580,000 payable in annual installments of \$29,000 at 8% interest until 2007, secured by the Municipality.	87,000
Operational loan of \$540,000 payable in annual installments of \$27,033 at 8% interest until 2008, secured by the Municipality.	114,891
Operational loan of \$15,385,000 payable in annual installments from \$260,000 to \$1,185,000 with interest fluctuating from 3.65 to 6.67 until 2027, secured by the Municipality.	<u>14,845,000</u>
Total loans	<u>\$ 18,861,891</u>
Total general long-term debt	<u>\$105,511,088</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Long-term debt for enterprise funds at June 30, 2004 is summarized as follows:

Special bond obligation for \$500,000 to provide financing for the construction and rehabilitation of housing project for citizens of low and moderate income; annual interest rate at 2% with maturity of January 1, 2010, secured by the Municipality.	\$369,750
Special bond obligation for \$300,000 to provide for financing the reconstruction and rehabilitation of housing project for citizens of low and moderate income; annual interest rate at 2% with maturity of July 30, 2012, secured by the Municipality.	256,965
Operational loan of \$5,185,000 payable in annual installments from \$90,000 to \$400,000 with interest fluctuating from 3.65 to 6.67 until 2027, secured by the Municipality.	<u>5,000,000</u>
Total long-term debt	<u>\$5,626,715</u>

The debt service requirement for the long-term debt of Enterprise funds is scheduled as follow:

<u>Fiscal year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 182,610	\$ 373,778	\$ 556,388
2005	182,610	324,506	507,116
2006	188,246	317,788	506,034
2007	198,894	310,346	509,240
2008	204,548	302,200	506,748
2009-2013	1,004,434	1,366,112	2,370,546
2014-2018	1,005,000	1,091,188	2,096,188
2019-2023	1,370,000	714,751	2,084,751
2024-2028	1,290,373	3,510,685	4,801,058
	<u>\$ 5,626,715</u>	<u>\$ 8,311,354</u>	<u>\$ 13,938,069</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Note 8 - Retirement System

The Municipality participates in the Employee's Retirement System of the Government of Puerto Rico and its instrumentalities (ERS), a multiple-employer contributory retirement plan, which covers only eligible full-time employees. The system provides retirement, death, and disability benefits and annuities to Commonwealth employees not covered by their own systems.

Commonwealth legislation required 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 participants' gross salary. Total employer contributions during the year ended June 30, 2004 amounted to approximately \$ 2,316,500.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1991, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating 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 on or after January 1, 2000 will only be allowed to become members of the System 2000. System 2000 will reduce the retirement age from 65 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 the System 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% of the employees' salary up to a maximum of 10%) will be invested in account which 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 System 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.

For the year ended June 30, 2004, total covered payroll was approximately \$24,975,827. Covered payroll refers to all compensation paid by the Municipality to employees covered by the ERS on which contributions to the pension are based.

COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

The amount of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years, for those employees covered after March 31, 1990, the annuity shall be equal to one and one-half percent of the average compensation multiplied by the number of years of creditable service, in no case shall the annuity be less than \$2,400.

Note 9 - Commitments

A. Operating leases

The Municipality leases various properties and equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed if sufficient funds are available. Lease agreements covering periods in excess of one-year are cancelable at the Municipality's option upon 30 days written notice to the lessor. Rental expenditures for the year ended June 30, 2004 amounted to approximately \$1,008,800.

Future operating lease commitments are scheduled as follows:

2005	\$ 265,434
2006	162,024
2007	89,592
2008	179,184
2009	89,592
	<u>\$ 785,826</u>

B. General commitments

The Municipality has commitments to invest approximately \$47,815,000 to complete construction projects at several locations within the Municipality. Federal funds amounting to \$11,412,000 and municipal funds amounting to approximately \$36,403,000 are expected to be used to satisfy these construction and improvement commitments.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Note 10 - Contingencies

A. Litigation

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of \$449,400 in the government-wide statements for anticipated unfavorable judgments.

The amount presented in the general long-term debt of the statement of net assets represents the amount estimated as probable liability, which will require future available financial resources for its payment. The Municipality's administration and legal counsel believes that the ultimate liability in excess of amounts provided would not be significant. In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available cannot determine the final outcome of these claims. As a result, the accompanying general-purpose financial statements do not include adjustments, if any, that could result from the resolution of these legal proceedings.

B. Federal financial assistance

The Municipality receives financial assistance from the federal government in the form of grants or entitlements. The Municipality recognizes federal grant revenues when the related grant agreements are approved and notified by the federal agencies by written communication. All grants are subject to financial and compliance audits by the grantor agencies, which could result in requests for reimbursement by the grantor agencies for expenditures, if disallowed under the terms of the grants. These amounts, if any, of expenditures, which may be disallowed by the granting agencies, cannot be determined at this time. The Municipality's administration believes that such disallowances, if any, will not have a material adverse effect on the financial position of the Municipality.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)

JUNE 30, 2004

Note 11 – Healthcare costs

During the year ended June 30, 2000 the Governor of the Commonwealth of Puerto Rico required to the municipalities of Puerto Rico an annual contribution to subsidize the cost of the implementation and administration of the Healthcare Reform. Such contributions are required to be disbursed from general fund operating budget. Total contributions made by the Municipality amounted to approximately \$7,675,000 for the fiscal year ended June 30, 2004.

Note 12 – Subsequent event

By means of Law No. 137, of August 9, 2002, which amended the Law No. 81 for the municipalities of Puerto Rico, the Municipality created, on November 12, 2003, the "Corporación de Bellas Artes de Caguas (COBAC, by its abbreviation in the Spanish language)". This legal entity replaced the enterprise activity of the Fine Arts Center during fiscal year 2004-2005. In fact, on October 8, 2004, representatives of the Municipality and COBAC signed a contract in which the Municipality transferred to COBAC the management of the Fine Arts Enterprise, including the real and personal property, activities and businesses that operate in such facilities. This contract was formalized for a term of fifteen (15) years effective July 1, 2004 by which COBAC is required to pay the Municipality an annual rent of \$1,000 for the use of the facilities of the Fine Art Center.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAGUAS

NOTES TO THE FINANCIAL STATEMENTS (continued)
JUNE 30, 2004

Note 13 - Prior period adjustments

Fund statements:

During the fiscal year ended June 30, 2004, the Municipality implemented a new accounting system for its financial transactions. As part of this process the Municipality regrouped the fund balances of certain funds which until June 30, 2003 were reported in the Other Special Revenue Funds group. As a result, the Municipality restated the beginning fund balances of such fund group by \$23,380,271 and classified this amount as follows:

Inclusion of the fund balances of Home Investment, Self Help and Rental Rehabilitation in the Housing Rental Program major fund	\$ 6,945,664
Presentation of the Public Residential Administration fund as major	767,086
Inclusion of the fund balances of Child Care, Child Care Food and Parents Contribution in the Head Start funds	3,984,614
Inclusion of the fund balance of the resources relates with legislative contributions in the Legislative fund	702,583
Inclusion in the Capital Project major fund the fund balances of Community Development Block Grant, Urban Development Action grants and other municipal funds reserved for construction Projects	<u>10,980,324</u> \$ 23,380,271