

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

**MUNICIPIO DE CANOVANAS**  
**AUDITORIA 2002-2003**  
**30 DE JUNIO DE 2003**

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS**

**SINGLE AUDIT REPORT**

June 30, 2003

*Canóvanas*

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS  
Basic Financial Statements and  
Supplemental Schedule  
June 30, 2003**

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**Independent Auditors' Report on Basic Financial Statements and  
Supplementary Schedule of Expenditures of Federal Awards**

The Honorable Mayor, Members of the  
Municipal Legislature and People of  
the Municipality of Canóvanas  
Canóvanas, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Canóvanas of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2003, which collectively comprise the Municipality's basic financial statements as listed in the accompanying 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 and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. 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 statements 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, each major fund, and the aggregate remaining fund information of the Municipality of Canóvanas of the Commonwealth of Puerto Rico, as of June 30, 2003, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards we have also issued our report dated December 17, 2003, on our consideration of the Municipality of Canóvanas of the Commonwealth of Puerto Rico internal control over financial reporting and on our test of its compliance with certain provisions of laws, regulations, contracts and grants. 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.

As described in Note 1, on July 1, 2002 the Municipality implemented a new financial reporting model required for state and local governments established by the Governmental Accounting and Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. As more fully described in Note 1, as part of the adoption of the new financial reporting model, on July 1, 2002 the Municipality also adopted the provisions of other pronouncements issued by GASB, the Accounting Principles Board ("APB") and the Financial Accounting Standards Board ("FASB").

The effects of implementing the aforementioned pronouncements have been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the effects of such transactions have been retroactively reported as restatements of fund balances in the accompanying fund financial statements at July 1, 2002.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule are not required parts of the basic financial statements referred to above, 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.

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

December 17, 2003  
Toa Alta, Puerto Rico

Stamp No. 1851716  
was affixed to  
the original report.

 - CPA-PSC

 BENITEZ-JAIME, CPA-PSC

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management of the Municipality of Canóvanas of the Commonwealth of Puerto Rico (the "Municipality") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2003, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, issued by the Governmental Accounting Standards Board (commonly known as "GASB 34"). According to this statement, significant required changes in content and structure have been made in the accompanying Municipality's basic financial statements as of and for the fiscal year ended June 30, 2003, which make the accompanying basic financial statements not easily comparable to the Municipality's general purpose financial statements issued in prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of GASB 34, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget), and;
- e) Identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the accompanying basic financial statements.

#### **FINANCIAL HIGHLIGHTS**

- The Municipality's has reported assets and net assets amounting to \$43,495,402 and \$13,336,128 respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to \$21,660,952 (50 percent of total Municipality's assets).
- The Municipality has reported total liabilities amounting to \$30,159,274 in the accompanying statement of net assets, of which the most significant liabilities are: (1) deferred revenues (\$7,347,118), (2) bonds and notes payable (\$18,033,429) and (3) accrued compensated absences (\$2,284,169). These liabilities account for 92 percent of the Municipality's total liabilities at June 30, 2003.
- The Municipality has reported total revenues amounting to \$20,098,734 in the accompanying statement of activities, of which: (1) restricted capital and operating grants (\$3,860,070), (2) property taxes (\$6,872,459) and (3) municipal licenses (\$5,117,781) were the most significant revenues amounting to \$15,850,310 (79 percent of total revenues).
- The Municipality has reported a net change in net assets (excess of revenues over expenses) amounting to \$4,254,718 in the accompanying statement of activities.

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- The Municipality's governmental funds reported combined ending fund balances of \$7,080,425 of which \$5,044,836 (71 percent) represent the fund balances of the general fund, the debt service fund, the HUD Section 108 fund and the state legislative joint resolutions fund combined (jointly known as the Municipality's major funds).
- The Municipality has reported unreserved fund balance for the general fund amounting to \$1,795,700.
- The Municipality has reported an excess of expenditures and other financing uses over revenues and other financing sources amounting to \$397,827 in the governmental funds.

#### **USING THIS ANNUAL REPORT**

This annual report consists of a series of new financial statements with a change in the focus from the previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

#### **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedule) in addition to the basic financial statements themselves. These components are described below:

##### **Government-Wide Financial Statements**

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2003 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

##### **Statement of Net Assets**

The statement of net *assets* presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

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**Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2003. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

**Fund Financial Statements**

The Municipality's fund financial statements, which consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year (June 30, 2003). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing

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so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has four major funds: (1) the general fund, (2) the debt service fund, (3) the HUD Section 108 fund and (4) the state legislative joint resolutions fund.

**Notes to the Basic Financial Statements**

The 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 to the basic financial statements can be found immediately following the basic financial statements.

**Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

**INFRASTRUCTURE ASSETS**

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach), which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2002, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$13,336,128 at June 30, 2003.

The largest portion of the Municipality's net assets are invested in capital assets net of their related debt (\$10,398,171). The Municipality's net assets are also composed of net assets amounting to \$3,912,574 that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net assets are reported net of an unrestricted deficit of \$974,617.

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The unrestricted deficit is the consequence of previous budgets, which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens; consequently 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 the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

**Condensed Statement of Net Assets:**

Current and other assets	\$	12,783,701
Noncurrent and other assets		30,711,701
Total assets		43,495,402
Current liabilities		13,577,593
Noncurrent liabilities		16,581,681
Total liabilities		30,159,274
Net assets/(liabilities):		
Invested in capital assets, net of related debt		10,398,171
Restricted		3,912,574
Unrestricted (deficit)		(974,617)
Total net assets	\$	13,336,128

**Changes in Net Assets**

The Municipality's net assets increased by \$4,254,718 during the year. Approximately 74 percent of the Municipality's total revenues came from taxes, while 19 percent resulted from restricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (37 percent), urban and economic development (21 percent) and health and sanitation (17 percent).

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The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

**Condensed Statement of Activities:**

Revenues:	
Program revenues:	
Operating grants and contributions	\$ 2,312,772
Capital grants and contributions	1,547,298
Charges for services	156,656
General revenues:	
Property taxes	6,872,459
Municipal license taxes	5,117,781
Construction excise taxes	2,921,556
Other	1,170,212
Total revenues	<u>20,098,734</u>
Expenses:	
General government	5,826,160
Public safety	694,220
Health and sanitation	2,766,635
Urban and economic development	3,296,273
Culture, recreation and education	290,711
Public housing and welfare	2,247,613
Interest	722,404
Total expenses	<u>15,844,016</u>
Net increase in net assets	4,254,718
Net assets - at beginning of year	9,081,410
Net assets - at end of year	<u>\$ 13,336,128</u>

**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS**

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental Funds** - The focus of the Municipality's governmental *funds* is to provide information on near-term inflows, outflows, and balance of expendable *resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

**COMMONWEALTH OF PUERTO RICO  
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MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Condensed Balance Sheet - Governmental funds:**

Total Assets - Major Funds	\$	19,200,995
Total Assets - Nonmajor Funds		3,897,847
Total assets		23,098,842
Total Liabilities - Major Funds		14,156,159
Total Liabilities - Nonmajor Funds		1,862,258
Total liabilities		16,018,417
Fund Balances - Major Funds		5,044,836
Fund Balances - Nonmajor Funds		2,035,589
Total net assets	\$	7,080,425

**Condensed Statement of Operations - Governmental funds:**

Total Revenues and other financing sources - Major Funds	\$	21,972,931
Total Revenues and other financing sources - Nonmajor Funds		3,410,861
Total revenues		25,383,792
Total expenditures and other financing uses- Major Funds		20,428,263
Total expenditures and other financing uses- Nonmajor Funds		5,353,356
Total expenditures		25,781,619
Revenues/Sources over Expenses/Uses - Major		1,544,668
Revenues/Sources over Expenses/Uses - Nonmajor		(1,942,495)
Total net assets	\$	(397,827)

**GENERAL FUND BUDGETARY HIGHLIGHTS**

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

The accompanying Budgetary Comparison Schedule shows a total positive variance between budgeted revenues and actual revenue results of \$3,707,514, which was mainly caused by a positive variance of \$3,990,043 in other revenues.

In addition, the accompanying Budgetary Comparison Schedule shows a total negative between budgeted expenditures and actual expenditure results of \$6,470,338.

**COMMONWEALTH OF PUERTO RICO  
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MANAGEMENT'S DISCUSSION AND ANALYSIS**

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$32,313,405, of which \$5,400,818 represents infrastructure assets at June 30, 2003. The related accumulated depreciation and amortization of capital assets amounted to \$10,652,453, of which \$3,990,867 is related to infrastructure assets at June 30, 2003. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$9,423,021 for the year ended June 30, 2003. Depreciation and amortization charges for the year totaled \$854,034.

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

**Debt Administration**

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

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

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

**ECONOMIC FACTORS AND NEXT BUDGETS AND RATES**

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have

**COMMONWEALTH OF PUERTO RICO  
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been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal year. There were no significant changes between the budget for fiscal year 2002-2003 and the one for fiscal year 2003-2004.

**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's' accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mrs. Lilliam Rodríguez García, at PO Box 1612, Canóvanas, Puerto Rico, 00729.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Statement of Net Assets  
June 30, 2003

**ASSETS**

<b>Current Assets:</b>		
Cash and cash equivalents (notes 1g and 3)		\$ 3,067,207
Receivables, net of allowance for doubtful accounts (note 1h):		
Taxes:		
Property taxes (note 5)	\$ 6,025,779	
Municipal license taxes (note 4)	<u>3,329,514</u>	
Total taxes receivable	9,355,293	
Accrued interest (note 3)	6,430	
Intergovernmental (note 1h)	<u>277,002</u>	
Total receivables		9,638,725
Inventories (note 1i)		35,370
Prepaid expenses (note 1i)		<u>42,399</u>
Total current assets		<u>12,783,701</u>
<b>Noncurrent Assets:</b>		
Temporarily restricted cash and cash equivalents (notes 1j and 3)		8,989,195
Deferred charges, net of accumulated amortization (notes 1k)		61,554
Capital assets, net of accumulated depreciation and amortization (notes 1m and 7)		<u>21,660,952</u>
Total noncurrent assets		<u>30,711,701</u>
Total assets		<u>\$ 43,495,402</u>

**LIABILITIES**

<b>Current liabilities:</b>		
Accounts payable and other accrued liabilities (notes 1h)		1,123,734
Accrued interests on bonds, notes and obligations under capital leases (notes 9 and 10)		370,369
Intergovernmental (note 1h and 8)		121,120
Deferred revenues (notes 1n, 4 and 5)		7,347,118
Accrued compensated absences, excluding long-term portion (note 1o)		1,758,986
Obligation under capital leases, excluding long-term portion (notes 7, 9 and 10)		38,434
Bonds and notes payable (notes 1q and 9)		<u>2,817,832</u>
Total current liabilities		13,577,593
<b>Noncurrent liabilities:</b>		
Accrued compensated absences, excluding current portion (note 1o)		525,183
Claims and judgments (notes 1p, 9 and 11)		561,500
Reserve for federal costs disallowances (note 9)		158,500
Obligation under capital leases, excluding current portion (notes 7, 9 and 10)		120,901
Bonds and notes payable, excluding current portion (notes 1q and 9)		<u>15,215,597</u>
Total noncurrent liabilities		<u>16,581,681</u>
Total liabilities		<u>30,159,274</u>

**NET ASSETS**

Invested in capital assets, net of related debt	<u>10,398,171</u>	
Restricted for (note 1j):		
Debt service	438,947	
Capital projects	3,407,112	
Advances and other specified purposes	<u>66,515</u>	
Total restricted net assets	<u>3,912,574</u>	
Unrestricted net liabilities	<u>(974,617)</u>	
Total net assets		<u>\$ 13,336,128</u>

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

**MUNICIPALITY OF CANÓVANAS**  
Statement of Activities  
Year Ended June 30, 2003

Functions/Programs	Expenses	Charges for services and rents	Program Revenues		Expenses and Changes in Net Assets
			Operating Grants and Contributions	Capital Grants and Contributions	
<b>Governmental activities:</b>					
General government	\$ 5,826,160	\$ -	\$ 781,079	\$ -	\$ (5,045,081)
Urban and economic development	3,296,273			1,547,298	(1,748,975)
Public safety	694,220		170,063		(524,157)
Health and sanitation	2,766,635	156,656			(2,609,979)
Culture, recreation and education	290,711				(290,711)
Public housing and welfare	2,247,613		1,361,630		(885,983)
Interest on bonds, notes, capital lease obligations and long-term debt (notes 9 and 10)	722,404				(722,404)
<b>Total governmental activities</b>	<b>\$ 15,844,016</b>	<b>\$ 156,656</b>	<b>\$ 2,312,772</b>	<b>\$ 1,547,298</b>	<b>\$ (11,827,290)</b>

**General revenues:**

<b>Taxes:</b>	
Property taxes (note 5)	\$ 6,872,459
Municipal license taxes (note 4)	5,117,781
Construction excise taxes	2,921,556
Total taxes	<u>14,911,796</u>
Unrestricted interests, fines and penalties	442,569
Other revenues	727,643
Total general revenues	<u>16,082,008</u>
Net change in net assets	4,254,718
Net assets-beginning of fiscal year, as restated (note 12)	9,081,410
Net assets-end of fiscal year	<u>\$ 13,336,128</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Balance Sheet  
Governmental Funds  
June 30, 2003

	Major Funds				Other Governmental Funds	Total Governmental Funds
	General Fund	Debt Service Fund	Sec 108	Joint Resolutions		
<b>ASSETS</b>						
Unrestricted cash and cash equivalents (note 1g and 3)	\$ 3,067,207	\$ -	\$ -	\$ -	\$ -	\$ 3,067,207
Receivables, net of allowance for doubtful accounts:						
Taxes:						
Property taxes (note 5)	5,140,329	762,712	-	-	-	5,903,041
Municipal license tax (note 4)	3,329,514	-	-	-	-	3,329,514
Accrued interest or deposits (note 3)	1,111	1,371	-	-	3,948	6,430
Other miscellaneous	-	-	-	-	-	-
Total taxes receivable	8,470,954	764,083	-	-	3,948	9,238,985
Intergovernmental, principally from the governments of the Commonwealth of Puerto Rico and United States of America	-	-	-	-	183,486	183,486
Due from other funds (note 6)	453,415	501,094	-	573,850	91,610	1,619,969
Total receivables, net	8,924,369	1,265,177	-	573,850	279,044	11,042,440
Total current assets	11,991,576	1,265,177	-	573,850	279,044	14,109,647
Temporarily restricted cash and cash equivalents (note 1g and 3)	501,094	1,770,927	1,793,527	1,304,844	3,618,803	8,989,195
Total assets	<u>\$ 12,492,670</u>	<u>\$ 3,036,104</u>	<u>\$ 1,793,527</u>	<u>\$ 1,878,694</u>	<u>\$ 3,897,847</u>	<u>\$ 23,098,842</u>
<b>LIABILITIES</b>						
Account payable and accrued liabilities (note 1h)	\$ 181,158	\$ 303,415	\$ 341,218	\$ 13,246	\$ 386,772	\$ 1,225,809
Matured bonds due and payable (note 9)	-	845,000	-	-	-	845,000
Due to other funds (note 6)	1,067,428	4,013	14,271	75,818	458,439	1,619,969
Intergovernmental	121,120	-	-	-	-	121,120
Deferred revenues (notes 1n, 4 and 5)	8,829,185	570,657	-	1,789,630	1,017,047	12,206,519
Total liabilities	<u>10,198,891</u>	<u>1,723,085</u>	<u>355,489</u>	<u>1,878,694</u>	<u>1,862,258</u>	<u>16,018,417</u>
<b>FUND BALANCES</b>						
Encumbrances	498,079	-	-	-	-	498,079
Capital assets	-	-	1,438,038	-	1,969,074	3,407,112
Advances and other specified purposes	-	-	-	-	66,515	66,515
Debt service	-	1,313,019	-	-	-	1,313,019
Unreserved	1,795,700	-	-	-	-	1,795,700
Total fund balances (note 12)	<u>2,293,779</u>	<u>1,313,019</u>	<u>1,438,038</u>	<u>-</u>	<u>2,035,589</u>	<u>7,080,425</u>
Total liabilities and fund balances	<u>\$ 12,492,670</u>	<u>\$ 3,036,104</u>	<u>\$ 1,793,527</u>	<u>\$ 1,878,694</u>	<u>\$ 3,897,847</u>	<u>\$ 23,098,842</u>

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS**  
Statement of Revenues, Expenditures and  
Changes in Fund Balances - Governmental Funds  
Year Ended June 30, 2003

	Major Funds					Total Governmental Funds
	General Fund	Debt Service Fund	HUD Section 108	State Legislative Joint Resolutions	Other Governmental Funds	
<b>REVENUES:</b>						
Taxes:						
Property taxes (note 5)	\$ 3,272,363	\$ 1,012,382	\$ -	\$ -	\$ -	\$ 4,284,745
Municipal license taxes (note 4)	5,070,661					5,070,661
Construction excise taxes	2,921,556	-	-	-	-	2,921,556
Total taxes	11,264,580	1,012,382	-	-	-	12,276,962
Charges for services	156,656					156,656
Grants and contributions:						
Federal grants and contributions					2,948,491	2,948,491
State contributions	581,920			112,345	190,191	884,456
Interest, fines, and penalties	300,211	14,328	201	32	127,797	442,569
Other revenues	-	-	-	-	27,643	27,643
Total revenues	12,303,367	1,026,710	201	112,377	3,294,122	16,736,777
<b>EXPENDITURES:</b>						
Current:						
General government	5,080,942				256,220	5,337,162
Public safety	397,654				238,524	636,178
Urban development	2,775,254					2,775,254
Health and sanitation	2,704,396					2,704,396
Culture and education	290,078					290,078
Public housing and welfare	647,777				1,334,439	1,982,216
Capital outlays	3,208,971		2,873,499	112,345	3,228,206	9,423,021
Debt service:						
Principal (notes 1r and 10)	222,353	845,000			55,000	1,122,353
Interest on bonds and notes (notes 10 and 11)	113,646	511,162	-	-	72,980	697,788
Total expenditures	15,441,071	1,356,162	2,873,499	112,345	5,185,369	24,968,446
Excess (deficiency) of revenues over (under) expenditures	(3,137,704)	(329,452)	(2,873,298)	32	(1,891,247)	(8,231,669)
<b>OTHER FINANCING SOURCES (USES):</b>						
Proceeds from the sale of land	700,000					700,000
Proceeds from issuances of bonds (note 10)	3,375,000		3,771,867			7,146,867
Debt issue costs	(13,025)					(13,025)
Operating transfer-in from other funds (note 6)	141,732	501,094	40,583		116,739	800,148
Operating transfer-out to other funds (note 6)	(617,833)	(14,328)	-	-	(167,987)	(800,148)
Total other financing sources (uses)	3,585,874	486,766	3,812,450	-	(51,248)	7,833,842
<b>EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES AND OTHER FINANCING USES</b>	448,170	157,314	939,152	32	(1,942,495)	(397,827)
<b>FUND BALANCES AT BEGINNING OF YEAR, AS RESTATED (NOTE 12)</b>	1,845,609	1,155,705	498,886	(32)	3,978,084	7,478,252
<b>FUND BALANCES AT END OF YEAR</b>	\$ 2,293,779	\$ 1,313,019	\$ 1,438,038	\$ -	\$ 2,035,589	\$ 7,080,425

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

**MUNICIPALITY OF CANÓVANAS**  
**Reconciliation of Statement of Revenues,**  
**Expenditures and Changes in Fund Balances**  
**Governmental Funds to the Statement of Activities**  
**Year Ended June 30, 2003**

Amounts reported for governmental activities in the accompanying statement are different because:

Net change in fund balances as reported in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds	\$ (397,827)
Governmental funds report capital outlays as expenditures. However, in the accompanying 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.	8,568,987
Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the fund financial statements.	2,661,957
The issuance of long-term debt provides current financial resources to governmental funds while repayment of bond and notes principal is recorded as expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. Also, governmental funds report the effect of issuance costs, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of the three differences.	(6,011,489)
In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental funds, interest expenditure is reported when due.	(24,616)
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 governmental funds.	<u>(542,294)</u>
Net change in net assets as reported in the accompanying statement of activities	<u>\$ 4,254,718</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Notes to Basic Financial Statements  
June 30, 2003

**1. GOVERNMENTAL ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Government Background Information**

The Municipality of Canóvanas of the Commonwealth of Puerto Rico (the "Municipality") is a local government constituted in 1970 with full legislative, fiscal and administrative powers to operate as a government. The Municipality assumes responsibility for public safety, health and sanitation, public housing and welfare, culture and education, urban and development and many other general and administrative duties.

The laws and regulations of the Commonwealth of Puerto Rico (the "Commonwealth") provide for separation of powers of the executive, legislative and judicial branches of the Commonwealth's and the Municipality's governments. The executive power of the Municipality is exercised by a Mayor, who is elected every four years and is assisted by the Administrative Cabinet, which is appointed by the Mayor. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The judiciary power is exercised by the General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality.

**B. Financial Reporting Entity**

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

According to GAAP, the financial reporting entity for the Municipality consists of: (1) the primary government, which is composed of all municipal departments and units under the legal and administrative control of the Mayor and the Municipal Legislature, and (2) all component units.

In evaluating how to define the Municipality for financial reporting purposes, the Municipality's management has addressed all potential entities and organizations that may be considered component units according to the criteria set forth by Statement No. 14, *The Financial Reporting Entity*, as amended by Statement No. 39, *Determining Whether Certain Organizations are Component Units*, both issued by the Governmental Accounting Standards Board.

GAAP defines component units as those entities that: (1) are legally separate organizations for which the Municipality's elected officials are financially accountable, and (2) other organizations for which the nature and significance of their relationship with the Municipality are such that exclusion of their financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete. Financial accountability exists if the Municipality appoints a voting majority of the organization's governing body, and if either one of the following conditions exist: (1) the Municipality can impose its will on the organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

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GASB Statement No. 39, which was early adopted by the Municipality on July 1, 2002, amended the provisions of GASB Statement No. 14 to provide additional guidance to determine whether certain organizations for which the Municipality is not financially accountable should be reported as component units based on the nature and significance of their relationship with the Municipality. Generally, GASB Statement No. 39 requires reporting, as a discretely presented component unit, an organization that raises and holds economic resources for the direct benefit of a governmental entity. Such organizations are legally separate, tax-exempt entities that meet all of the three specific criteria that address benefit, entitlement or access, and significance.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations considered component units of the Municipality according to GAAP as of June 30, 2003 nor for the year then ended.

**C. New Financial Reporting Model**

On July 1, 2002, the Municipality adopted the provisions of Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (commonly known as "GASB 34"), issued by the Governmental Accounting Standards Board (GASB). This statement, as amended, established a new financial reporting model for state and local governments.

In addition, on July 1, 2001 the Municipality also adopted the following required statements issued by GASB and the Financial Accounting Standards Board ("FASB"):

- i. **GASB Statement No. 33** – *Accounting and Financial Reporting for Nonexchange Transactions;*
- ii. **GASB Statement No. 36** – *Recipient Reporting for Certain Shared Nonexchange Revenues;*
- iii. **GASB Statement No. 37** – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus;*
- iv. **GASB Statement No. 39** – *Determining Whether Certain Organizations are Component Units;*
- v. **GASB Interpretation No. 6** – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements;*

Simultaneously to the adoption of GASB Statement No. 34, the Municipality adopted certain pronouncements issued by FASB and all of its predecessor bodies, such as the Accounting Principles Board (APB), for its governmental activities. In this respect, the Municipality adopted the pronouncements issued by these entities that were issued on or before November 30, 1989, and that do not conflict with GASB pronouncements. Accordingly, on July 1, 2002 the Municipality adopted the provisions of APB Opinion No. 21, *Interest on Receivables and Payables*, to account for non-interest bearing receivables and payables reported in the accompanying basic financial statements.

The effects of implementing the aforementioned pronouncements have been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the cumulative effects of such transactions have been reported retroactively as restatements of fund balances at July 1, 2002.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
**Notes to Basic Financial Statements**  
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According to the new financial reporting model established by GASB 34, as amended, the minimum required presentation for financial reporting purposes of the Municipality is composed of the following elements:

1. **Management's Discussion and Analysis ("MD&A")** – MD&A is a required supplementary information used to introduce the basic financial statements and provide an analytical overview of the Municipality's financial activities for the year ended June 30, 2003 based on the Municipality's management knowledge of the transactions, events and conditions reflected in the basic financial statements and the fiscal policies that control the Municipality's operations.
2. **Government-Wide Financial Statements ("GWFS")** – GWFS is a set of financial statements composed of: (1) a statement of net assets and (2) a statement of activities.

The government-wide financial statements are aimed at presenting a broad overview of the Municipality's finances by focusing on operational accountability through reporting the financial position and results of operations of the Municipality as a whole using methods that are similar to those used by most private businesses.

The statement of net assets provides short-term and long-term information about the Municipality's financial position, which assist management to determine the Municipality's economic condition at June 30, 2003 by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Net assets are reported in the following three categories:

- **Invested in Capital Assets, Net of Related Debt** – This consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These result when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Municipality's policy to use restricted resources first, and then unrestricted resources as they are needed.
- **Unrestricted Net Assets** – These consist of net assets which do not met the definition of the two preceding categories. Unrestricted net assets often are designed, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

The statement of activities presents financial information showing how the Municipality's net assets changed during the year ended June 30, 2003. The statement of activities demonstrates the degree to which direct expenses of a given function or

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segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. Program revenues include charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function, segment or operational unit. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. The Municipality does not allocate general government (indirect) expenses to other functions.

Under the provisions of GASB 34, all activities carried out by the Municipality are considered governmental in nature for financial reporting purposes. As a result, no business-type activities are reported in the accompanying basic financial statements.

3. **Fund Financial Statements ("FFS")**— FFS is a set of financial statements composed of: (1) a balance sheet (financial position) and (2) a statement of revenues, expenditures and changes in fund balances (deficits) of the Municipality's governmental funds (results of operations).

The fund financial statements focus on: (1) financial accountability, (2) individual parts of the Municipality's government and (3) reporting the Municipality's operations in more detail than the government-wide financial statements.

Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions. The minimum number of funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its funds within the following governmental fund categories:

**General Fund** – The general fund is the chief operating fund used to account for all financial resources and governmental activities of the Municipality, except for financial resources required to be accounted for in another fund type. It is presumed that the Municipality's activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a fund other than the general fund.

**Special Revenue Funds** – The special revenue funds are used to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes.

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**Debt Service Fund**— The debt service fund is used to account for the accumulation of resources for, and the payment of, principal and interest for: (1) general long-term debt for which debt service payments are legally mandated to be accounted for in a debt service fund, and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years (such bonds payable and notes payable).

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as capital leases, compensated absences, claims and judgments and advances from CRIM, are accounted for in the general fund.

Long-term debt's principal and accrued interest due on July 1 of the following fiscal year are accounted for as liabilities in the debt service fund at June 30, if resources are available at June 30 for its payment.

**Capital Projects Funds** – Capital projects funds are used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities.

The routine purchase of capitalizable assets (such as vehicles and other minor capital assets) has been reported in the general fund.

The Municipality has no significant operations or activities that: (1) are financed and operated primarily in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges, or (2) are fiduciary in nature. As a result, the Municipality does not report proprietary nor fiduciary funds in the accompanying fund financial statements. All Municipality' funds are classified as governmental for financial reporting purposes.

4. **Notes to the Basic Financial Statements** – A set of notes that provide information that is essential to a user's understanding of the basic financial statements.
5. **Required Supplementary Information (other than MD&A)** – A set of reports and information reported along with, but separate from, the basic financial statements of the Municipality, such as: (1) Budgetary Comparison Schedule – General Fund, (2) the Notes to Budgetary Comparison Schedule (3) the Schedule of Funding Progress - Employees' Retirement System of the Commonwealth of Puerto Rico and Its Instrumentalities (4) Schedule of Expenditures of Federal Awards and (5) Notes to Schedule of Expenditures of Federal Awards.

**D. Measurement Focus and Basis of Accounting**

The term measurement focus refers to what is being expressed in reporting financial position and performance, that is, which resources are being measured in the accompanying basic financial statements. Two different measurement focuses have been applied in the accompanying basic

**COMMONWEALTH OF PUERTO RICO**  
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financial statements: (1) the flow of current financial resources and (2) the flow of economic resources. Basis of accounting refers to when transactions have been recognized in the accompanying basic financial statements. GAAP provides for the use of two different bases of accounting, which have been used in the accompanying basic financial statements: (1) the accrual basis and (2) the modified accrual basis.

The accompanying government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenues are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund activities have been eliminated from these government-wide financial statements.

The accompanying fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available (that is, earned and collected or expected to be collected within the next 90 days following the fiscal year-end) to pay liabilities of the current period, except property tax revenues, for which the availability period is 60 days.

In applying the susceptible to accrual concept to intergovernmental revenue in the accompanying fund financial statements, there are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, generally recognized as expenditures are incurred. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are generally reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

In the accompanying fund financial statements, expenditures and related liabilities are generally recorded in the accounting period in which the liability is incurred, except for: (1) principal payment and interest on long-term obligations, which are recorded when due, except for principal and interest due in July 1 of the following fiscal year which are recorded when resources are available in the debt service funds (generally June 30); and (2) vacation leave, sick leave, Christmas bonus, obligations under capital leases, amounts subject to judgments under litigation, and other long-term obligations, which are recorded under the accrual basis of accounting in the accompanying government-wide financial statements.

In December 1998, the Governmental Accounting Standards Board issued Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* ("GASB 33"), effective for financial statement for periods after June 15, 2000, which the Municipality adopted on July 1, 2002. This statement established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. The statement groups nonexchange transactions of governments into four classes, based on their principal characteristics: (a) derived tax revenue; (b) imposed nonexchange revenue; (c) government

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mandated nonexchange transactions; and (d) voluntary nonexchange transactions. The adoption of this statement altered significantly the basis of accounting used by the Municipality for the recognition of revenue and expenditures and related assets and liabilities, as described above. The effect of the adoption of this pronouncement has been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the cumulative effects of such transactions have been reported retroactively as restatements of fund balances at July 1, 2002.

**E. Major and Nonmajor Funds**

Under the provisions of GASB 34, the Municipality is required to segregate funds among major and nonmajor categories within the fund financial statements. Major individual governmental funds are reported as separate columns in the accompanying fund financial statements, while data from all nonmajor governmental funds are aggregated into a single column, regardless of fund type. At minimum a fund is considered major if: (1) it is the primary operating fund of the Municipality (i.e. the general fund) or; (2) meets both of the following criteria:

- (a) Total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding total for all funds of that category or type; and,
- (b) Total assets, liabilities, revenues, or expenditures of the individual governmental fund are at least 5 percent of the corresponding total for all governmental funds combined.

Based on the above-mentioned criteria, the Municipality's general fund, the CDBG fund and the debt service fund are the only three funds that qualify as major funds for the fiscal year ended June 30, 2003, and accordingly, have been reported as major funds in the accompanying fund financial statements. All other governmental funds of the Municipality are considered nonmajor for financial reporting purposes.

**F. Statutory (Budgetary) Accounting**

The Municipality's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. Revenue is generally recognized when cash is received.

Expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment.

Under the statutory basis of accounting, the Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control.

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The accompanying budgetary comparison schedule – general fund, only presents the information for the general fund, which is the only Municipality's fund with a legally adopted budget, as required by GAAP. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of differences in the deficiency of revenues and other financing sources under expenditures and other uses of financial sources for the year ended June 30, 2003 was presented for the general fund as part of the accompanying budgetary comparison schedule.

**G. Cash and Cash Equivalents**

The Municipality's cash and cash equivalents are composed of cash on hand, demand deposits, and short-term investments in certificates of deposit with original maturities of three months or less from the date of acquisition.

The Municipality follows the practice of pooling cash and cash equivalents. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing deposits with private commercial banks.

Cash with fiscal agent in the debt service fund represents additional property tax collections retained by the Municipal Revenue Collection Center ("CRIM", by its Spanish Acronym), a municipal corporation (not a component unit of the Commonwealth nor of the Municipality). Such cash balances are restricted for the payment of the Municipality's debt service, as established by law.

Cash equivalents consist of investments in certificates of deposit with original maturities of 90 days or less, which amounted to \$1,500,000 at June 30, 2003.

**H. Receivables and Payables**

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans).

Tax receivables in the general fund represent amounts owed by taxpayers principally for individual and corporate property taxes, municipal license taxes and construction excise taxes. A portion of these tax receivables is recognized when they become measurable and available based on actual collections during the 90 days (60 days for property taxes) following the fiscal year-end related to tax returns due before year-end. Tax receivables also include amounts owed by taxpayers from taxable years prior to June 30, 2003, estimated to be collectible but not currently available, as a result of the adoption of GASB 33.

Accounts receivables are stated net of estimated allowances for doubtful accounts, which are determined based upon past collection experience and current economic conditions. Intergovernmental receivables mainly represent amounts owed to the Municipality by the Commonwealth and the federal government of the United States of America for: (1) intergovernmental charges, and (2) for reimbursement of expenditures incurred pursuant to federally funded programs, respectively.

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In the accompanying government-wide financial statements, receivables consist principally of all revenues earned at year-end and not yet received. Allowances for doubtful accounts are based upon historical trends and the periodic aging of accounts receivable. Major receivable balances for the governmental activities include municipal license taxes, property taxes and construction excise taxes, among others.

Nonexchange transactions collectible but not available are deferred in the accompanying fund financial statements in accordance with the modified accrual basis of accounting, but not deferred in the accompanying government-wide financial statements in accordance with the accrual basis of accounting. Interest income is recorded when earned only if collected within 90 days after year-end since they would be considered both measurable and available. Allowances for uncollectible accounts receivable are based upon historical trends and the periodic aging of accounts receivable.

**I. Inventories and Prepaid Expenses**

Inventories consist of materials and supplies held for consumption. Generally, inventories and prepaid expenses are valued at cost and predominantly on the first-in, first-out basis. Governmental fund inventories and prepaid expenses are recorded as expenditures (consumption method) when purchased rather than capitalized as an asset. Only significant amounts of inventory and prepaid expenses at the end of the year would be capitalized, if any, in the governmental funds. However, inventories are always capitalized (purchase method) in the statement of net assets.

**J. Temporarily Restricted Assets**

Certain cash and cash equivalents set aside by the general fund, the capital projects fund and the special revenue fund are classified as temporarily restricted assets since their use is limited for: (a) the compliance with debt service requirements of bonds and notes payable as established in the respective debt agreements, (b) the funding of construction and permanent improvement projects, and (c) the funding of federal and state sponsored programs. Temporarily restricted cash and cash equivalents amounted to \$8,989,195 (note 3) at June 30, 2003.

**K. Deferred Charges**

Deferred charges in the accompanying statement of net assets consist of debt bond issuance costs, which are amortized over the term of the related debt using the straight-line method. In the fund financial statements, bond issuance costs are recognized in the current period as expenditure, whether or not withheld from the actual debt proceeds received.

**L. Interfund Transactions**

Permanent reallocations of resources between the Municipality's funds are classified as interfund transfers. The Municipality has the following types of transactions recorded among funds in the accompanying fund financial statements:

- ***Operating Transfers*** – Legally required transfers that are reported when incurred as “operating transfers-in” by the recipient fund and as “operating transfer-out” by the disbursing fund.

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- **Interfund Payments (Quasi-external Transactions)** – Charges or collections for services rendered by one fund to another that are recorded as revenue of the recipient fund and as expenditure of the disbursing fund.

For the purposes of the accompanying government-wide statement of activities, all interfund transfers between individual governmental funds have been eliminated.

**M. Capital Assets**

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus. General capital assets are long-lived assets of the Municipality as a whole, such as land, land improvements, easements, buildings, building improvements, vehicles, machinery, equipment, works, infrastructure and all other intangible assets that are used in the operations of the Municipality and that have initial useful lives extending beyond a single reporting period (fiscal year). Infrastructure assets are generally immovable in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets. In the accompanying government-wide statement of net assets, all individual capital assets over the threshold amount of \$500 have been capitalized and depreciated.

In the accompanying government-wide statement of net assets, all capital assets are valued at their historical cost or estimated historical cost if actual is unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical cost was used to value the majority of the assets acquired prior to June 30, 2003. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

All capitalized assets are depreciated over their estimated useful lives under the straight-line method. All individual capital assets under the above mentioned capitalization threshold are charged directly to expense in the accompanying government-wide statement of activities. The estimated useful lives of major capital asset categories are:

Land improvements	20 years
Buildings and building improvements	50 years
Infrastructure	20 to 50 years
Motor vehicles	8 years
Furniture and fixtures	5 to 20 years
Machinery and equipment	5 to 20 years

Equipment held under capital leases is depreciated under the shorter of its estimated useful life of the assets or the lease term. Capital assets are recorded as capital outlays expenditures in the acquiring fund for the purposes of the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds.

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**N. Deferred Revenues**

The Municipality reports deferred revenue on its basic financial statements. Deferred revenue arises when potential revenue does not meet both the "measurable" and "available" criteria for revenue recognition in the current period. Available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. Deferred revenues also arise when the Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized. Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

Deferred revenues at June 30, 2003 amounted to \$7,347,118 and \$12,206,519 in the accompanying government-wide statement of net assets and balance sheet – governmental funds, respectively.

**O. Compensated Absences**

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by the Governmental Accounting Standards Board (GASB 16).

Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. According to GASB 16, the liability for compensated absences recorded in the accompanying government-wide statement of net assets is strictly limited to leave that: (1) is attributable to services already rendered on or before June 30, 2003, and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences, include salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security taxes, Medicare taxes, employer contributions to retirement system and others).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year). Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed. Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave days are not paid to the employee. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employees at any time. At June 30, 2003, the Municipality has recorded a liability for compensated absences amounting to \$2,284,169 in the accompanying government-wide statement of net assets.

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**P. 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.

**Q. Long-Term Debt**

All long-term debt to be repaid from governmental resources is reported as liabilities in the government-wide statement of net assets, except for principal and interest payment on long-term obligations due in July 1 of the following fiscal year, which is recorded in the fund financial statements when resources are available in the debt service fund (generally at June 30). Bonds and notes premiums and discounts, as well as, issuance costs, are deferred and amortized over the life of the debt in the accompanying government-wide financial statements.

Long-term debt for governmental funds is generally not reported as liabilities in the fund financial statements. In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses.

**R. Reservations of Fund Balances**

Reservations of fund balances represent portions of fund balances that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has the following types of reservations of fund balances:

- *Encumbrances* – Represent future expenditures under purchase orders and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- *Capital Assets* - Represents net assets available to finance future acquisitions of capital assets.
- *Debt Service* – Represents fund balances available to finance future debt service payments.
- *Advances and Other Specified Purposes* – Represent the reservation of moneys set aside principally for long-term commitments related to federally-funded programs.

**S. Risk Financing**

The Municipality purchases commercial insurance covering casualty, theft, tort claims, and other losses. The Commonwealth, through its Department of Treasury, pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments. The current insurance policies have not been canceled or terminated. For workers' compensation and disability insurance, the Municipality obtains insurance coverage through the State Insurance

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Fund Corporation (a component unit of the Commonwealth) and the Occupational Disability Fund (which is a trust fund administered by the Department of Labor and Human Resources of the Commonwealth).

**T. Total Columns**

Total columns on the fund financial statements are presented only to facilitate financial analysis. Data in these columns does not present consolidated financial position or results of operations in conformity with GAAP. Such data is not comparable to a consolidation since interfund eliminations have not been made in the accompanying fund financial statements.

**U. Use of Estimates**

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

**2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY**

The Municipality's general fund is the only governmental fund for which an annual budget is legally adopted. The Municipality's elected Mayor is legally required to prepare and submit to the elected Municipal Legislature an annual balanced budget for the ensuing fiscal year. The annual budget is prepared by the Municipality's Department of Finance, and takes into consideration the advice provided by all municipal departments and divisions. The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year, unless the imposition of taxes sufficient to cover said appropriations is provided by law.

The annual budget, which is developed utilizing elements of performance-based program budgeting and zero-based budgeting, includes an estimate of revenues and other financing resources of the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) municipal legislative measures proposed by the Mayor and submitted with the proposed budget, as well as the Mayor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year governmental plan adopted by the Municipality.

The Municipal Legislature may amend the budget submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon approval by the Municipal Legislature, the budget is referred to the Mayor who may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Mayor may also veto the budget in its entirety and return it to the Municipal Legislature with his objections. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve a new budget. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

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The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP. Accordingly, for budgetary purposes the Municipality uses encumbrance accounting. The encumbrances (principally purchase orders and contracts) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of budgetary appropriations and GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments will be honored during the subsequent year. The encumbered balance of any appropriation of the general fund at the end of the fiscal year will lapse to the following fiscal year. In addition, the Municipal Legislature may direct that certain revenues be retained and made available for spending within a specific appropriation account.

Generally, expenditures may not exceed the level of spending authorized for an individual department or division of the Municipality. However, the Municipality is statutorily required to satisfy the debt service requirements, regardless of whether such amounts are appropriated or not.

Appropriations are enacted for certain departments and divisions. Appropriations for capital projects are made for each bond/note issue and the authorization continues for the expected construction period.

The Municipality's Finance Department has the responsibility to ensure that budgetary spending control is maintained on an individual department/division basis. The Finance Department may transfer part or all of any encumbered balance within a department to another department subject to approval. Budgetary control is exercised through the Municipality's accounting system. This system ensures that encumbrances or expenditures are not processed if they exceed the department/division's total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for the general fund expenditures, principal and interest due for the year for the debt service fund, and by bond/note authorization for capital expenditures.

The annual budget as presented in the accompanying Budgetary Comparison Schedule – General Fund is the budget ordinance at June 30, 2003 representing the original budget, as amended. There were no supplemental appropriations for the year ended June 30, 2003.

### **3. DEPOSITS**

The Municipality maintains its deposits of cash in the Government Development Bank for Puerto Rico ("GDB") (a governmental bank and component unit of the Commonwealth) who serves as fiscal agent of the Municipality; and in various commercial banks located in Puerto Rico. The balances deposited in GDB are uninsured and uncollateralized. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation ("FDIC") up to a maximum of \$100,000 per depositor. However, under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance provided by the FDIC. All securities pledged as collateral are held by an agent of the Secretary of the Treasury of the Commonwealth in the name of the Municipality.

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Cash, cash equivalents and investments at June 30, 2003 consist of the following:

	Included in					Total
	General Fund	Debt Service Fund	HUD Section 108 Fund	State Legislative Joint Resolutions Fund	Other Governmental Funds	
Unrestricted cash and cash equivalents in commercial bank	\$ 3,067,207	\$ -	\$ -	\$ -	\$ -	\$ 3,067,207
Temporarily restricted cash and cash equivalents	501,094	1,770,927	1,793,527	1,304,844	3,618,803	8,989,195
<b>Total</b>	<b>\$ 3,568,301</b>	<b>1,770,927</b>	<b>1,793,527</b>	<b>1,304,844</b>	<b>3,618,803</b>	<b>\$ 12,056,402</b>

Cash and cash equivalents consist of demand deposits and certificates of deposit with original maturities of less than three months amounting to \$2,500,000.

The Municipality's bank balance of deposits with financial institutions are categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2003. Risk categories are described as follows:

- Category 1:** Insured or collateralized with securities held by the Secretary of the Treasury' agents in the Municipality's name.
- Category 2:** Collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.
- Category 3:** Uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

The carrying amount (book balance) and the bank balance of deposits with financial institutions of the Municipality at June 30, 2003 consist of the following:

	Carrying Amount	Bank Balance
Deposits in commercial banks	\$ 7,490,348	\$ 7,943,515
Deposits with fiscal agent	4,566,054	4,566,054
<b>Total</b>	<b>\$ 12,056,402</b>	<b>\$ 12,509,569</b>

Bank balances of deposits are classified as follows:

Category 1	\$ 7,943,515
Category 3	4,566,054
<b>Total bank balances</b>	<b>\$ 12,509,569</b>

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**4. MUNICIPAL LICENSE TAXES**

The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$ 1 million or more must include rates are established by the Municipality. At June 30, 2003, the municipal tax rates imposed by the Municipality were 1.50 percent for financing institutions and 0.30 percent for any other taxpayers. Any taxpayers, who have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth, ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return every April 15 based on the actual volume of business generated in the preceding calendar year. The tax can be paid by the taxpayer in two equal installments: (1) the first payment due at the filing date of the return (generally April 15), and (2) January 15 subsequent to the filing of the declaration. The first installment of the tax covers the taxable period (six months) ended December 31 subsequent to the filing date of the declaration, while the second installment of the tax covers the taxable period (six months) ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (April 15), a 5 percent discount is granted automatically on the tax amount due.

Any municipal license taxes collected in advance (that is, prior to June 30 but pertaining to the next fiscal year) are recorded as deferred revenues. As of June 30, 2003, the total municipal license tax receivable (net of the allowance for estimated uncollectible amounts) and the respective deferred revenues amounted to \$3,329,514 and \$4,540,441, respectively, in the accompanying government-wide financial statements.

**5. PROPERTY TAXES**

The Municipality is authorized by law to impose and collect personal and real property taxes. Personal property taxes can be imposed to any natural or legal person engaged in trade or business that at January 1 of each year is owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. At June 30, 2003, the total personal property tax rate in force was 6.28 percent (of which taxpayers pay 6.08 percent and .20 percent is reimbursed by the Department of Treasury of the Commonwealth. Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated at 1957 market prices. At June 30, 2003, the total real property tax rate in force was 8.28 percent (of which 8.08 percent is paid by taxpayers).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury of the Commonwealth assumes payment of the basic tax (4.00 and 6.00 percent for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500

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(at 1957 market prices), for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the general fund when collections are received from the CRIM.

CRIM is required to remit 1.03 percent of the personal and real property tax collected to the Municipality to be used for the partial funding of the debt service requirements on general obligations and notes payable of the Municipality. In addition, 1.25 percent of the total personal and real property taxes collected by CRIM is restricted for debt service requirements of the Municipality and is retained by GDB for such purposes. Accordingly, such amount is recorded as revenues in the debt service fund when collected and reported by the CRIM.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35 percent corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform is covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

As of June 30, 2003, the total property tax receivable (net of allowance for estimated uncollectible amounts) amounted to \$6,025, 779.

**6. INTERFUND BALANCES**

On July 1, 2001 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures, issued by the Governmental Accounting Standards Board*. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2003 consisted of the following:

	Operating Transfer from:						Total
	Major Funds						
Operating Transfers to:	General Fund	Debt Service Fund	HUD Section 108 Fund	State Legislative Joint Resolutions Fund	Other Capital Project Funds	Special Revenue Fund	
Major funds:							
General fund	\$ -	\$ 501,094	\$ -	\$ -	\$ 10,483	\$ 106,256	\$ 617,833
Debt service fund	14,328	-	-	-	-	-	14,328
HUD Section 8 fund	-	-	-	-	-	-	-
State legislative joint resolutions fund	-	-	-	-	-	-	-
Nonmajor funds:							
Special revenue fund	-	-	-	-	-	-	-
Other capital projects fund	127,404	-	40,583	-	-	-	167,987
<b>Total</b>	<b>\$ 141,732</b>	<b>\$ 501,094</b>	<b>\$ 40,583</b>	<b>\$ -</b>	<b>\$ 10,483</b>	<b>\$ 106,256</b>	<b>\$ 800,148</b>

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Due To:	Due From:						Total
	Major Funds						
	General Fund	Debt Service Fund	HUD Section 108 Fund	State Legislative Joint Resolutions Fund	Special Revenue Fund	Other Capital Project Funds	
Major funds:							
General fund	\$ -	\$ 497,081	\$ -	\$ -	\$ -	\$ 570,347	\$ 1,067,428
Debt service fund	4,013	-	-	-	-	-	4,013
Nonmajor funds:							
Special revenue fund	349,604	-	-	-	-	-	349,604
Capital projects fund	103,811	-	-	75,818	-	19,295	198,924
<b>Total</b>	<b>\$ 457,428</b>	<b>\$ 497,081</b>	<b>\$ -</b>	<b>\$ 75,818</b>	<b>\$ -</b>	<b>\$ 589,642</b>	<b>\$ 1,619,969</b>

At June 30, 2003 all amounts due to among funds are considered collectible by the Municipality's management.

**7. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2003, was as follows:

	Balance at June 30, 2002, as restated	Additions	Reclassifications	Balance at June 30, 2003
<b>COST BASIS:</b>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Infrastructure land	\$ 1,265,104	\$ -	\$ -	\$ 1,265,104
Construction in progress	2,079,386	6,230,201	(2,256,932)	6,052,655
Total cost basis of capital assets, not subject to depreciation and amortization	3,344,490	6,230,201	(2,256,932)	7,317,759
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	10,497,485			10,497,485
Infrastructure	3,143,886		2,256,932	5,400,818
Land Improvements	2,094,491			2,094,491
Licensed vehicles	2,619,263	3,192,820		5,812,083
Machinery and equipment	985,524			985,524
Equipment under capital leases	205,245	-	-	205,245
Total cost basis of capital assets subject to depreciation and amortization	19,545,894	3,192,820	2,256,932	24,995,646
Total cost basis of capital assets	\$ 22,890,384	9,423,021	-	\$ 32,313,405
	Balance at June 30, 2002	Depreciation and Amortization Expense	Reclassifications	Balance at June 30, 2003
<b>ACCUMULATED DEPRECIATION AND AMORTIZATION:</b>				
Buildings, structures and building improvements	\$ 2,181,327	209,703	-	\$ 2,391,030
Infrastructure	3,912,427	78,440	-	3,990,867
Land Improvements	954,642	90,464	-	1,045,106
Licensed vehicles	2,357,260	372,988	-	2,730,248
Machinery and equipment	379,833	61,689	-	441,522
Equipment under capital leases	12,930	40,750	-	53,680
Total accumulated depreciation and amortization	9,798,419	854,034	-	10,652,453
<b>CAPITAL ASSETS, NET</b>	<b>\$ 13,091,965</b>	<b>8,568,987</b>	<b>-</b>	<b>\$ 21,660,952</b>

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Depreciation and amortization expense was charged to functions in the accompanying government-wide statement of activities as follows:

General government	\$ 94,396
Public safety	46,357
Public housing and welfare	227,030
Health and sanitation	5,245
Culture, recreation and education	633
Urban and economic development	<u>480,373</u>
Total depreciation and amortization expense	<u>\$ 854,034</u>

**8. EMPLOYEES RETIREMENT SYSTEM**

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act. No. 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants. The System issues publicly available financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required to become members of System 2000.

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System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or later January 1, 2000.

**Funding Policy:**

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600 8.275% of gross salary over \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

During the fiscal year ended June 30, 2003 the employer's contributions paid by the Municipality to both retirement systems amounted to \$212,367. On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years of services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, the Commonwealth will assume any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Notes to Basic Financial Statements  
June 30, 2003

**9. LONG-TERM DEBT**

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2003, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2003 was as follows:

	Balance at June 30, 2002, as restated	Borrowings or Additions	Payments or Deductions	Other net changes	Balance at June 30, 2003	Due Within One Year
Bonds payables	\$ 8,475,000	\$ 3,375,000	\$ (685,000)	\$ -	\$ 11,165,000	\$ 845,000
Notes payable to Puerto Rico Treasury Department	2,373,915		(222,353)		2,151,562	1,917,832
Notes payable to HUD	1,000,000	3,771,867	(55,000)		4,716,867	55,000
Compensated absences	1,899,852	-	-	384,317	2,284,169	1,758,986
Claims and judgments	201,500	360,000	-	-	561,500	-
Reserve for federal cost disallowances	158,500	-	-	-	158,500	-
Obligation under capital leases	194,971	-	(35,636)	-	159,335	38,434
<b>Total</b>	<b>\$ 14,303,738</b>	<b>\$ 7,506,867</b>	<b>\$ (997,989)</b>	<b>\$ 384,317</b>	<b>\$ 21,196,933</b>	<b>\$ 4,615,252</b>

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Long-term debt at June 30, 2003 is composed of the following debts:

<u>General Obligation Bonds:</u>	<u>Outstanding Amount</u>
2003 serial bonds due in annual principal installments ranging from \$405,000 to \$565,000; plus interest due in semiannually installments at variable rates (5.00% to 5.50% at June 30, 2003) through July, 1, 2009	\$ 3,375,000
 <u>Public Improvement Bonds:</u>	
1992 serial bonds due in annual principal installments ranging from \$80,000 to \$255,000; plus interest due in semiannual installments at variable rates (4.37% to 6.36% at June 30, 2003) through July, 1, 2006	900,000

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Notes to Basic Financial Statements  
June 30, 2003

1995 serial bonds due in annual principal installments ranging from \$95,000 to \$265,000; plus interest due in semiannual installments at variable rates (4.70% to 6.88% at June 30, 2003) through July, 1, 2009	1,465,000
2001 serial bonds due in annual principal installments ranging from \$75,000 to \$475,000; plus interest due in semiannual installments at variable rates (2.70% to 5.60% at June 30, 2003) through July, 1, 2026	5,425,000

**Notes payable to the Puerto Rico Treasury Department:**

2001 operating loan with the Department of Treasury due in monthly principal installments ranging from \$25,000 to \$22,767; which includes implicit interest due in monthly installments at 5% through March 1, 2011	2,151,562
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**Notes Payable to HUD:**

2000 public improvement loan with HUD due in annual principal installments ranging from \$55,000 to \$385,000; plus interest due in semiannual installments at variable rates through August, 1, 2019	4,716,867
Accrued compensated absences	2,284,169
Legal claims and judgments	561,500
Reserve for federal cost disallowances	158,500
Obligation under capital leases	159,335
Total long-term debt	\$ 21,196,933

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

Year Ended June 30,	Principal	Interest	Total
2004	845,000	568,902	1,413,902
2005	910,000	529,517	1,439,517
2006	975,000	477,692	1,452,692
2007	1,040,000	421,693	1,461,693
2008	840,000	369,984	1,209,984
2009-2013	2,305,000	1,303,782	3,608,782
2014-2018	1,030,000	1,015,022	2,045,022
2019-2023	1,515,000	694,844	2,209,844
2024-2028	1,705,000	199,780	1,904,780
Totals	11,165,000	5,581,216	16,746,216

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Notes to Basic Financial Statements  
June 30, 2003

As described in Note 5, the Municipality levies an annual additional special tax of 1.75% of the assessed value of personal and real property. The proceeds of this additional special tax are required to be credited to the debt service fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected by CRIM as agent of the Municipality (see note 5).

**10. CAPITAL LEASES**

The Municipality has entered into various capital lease agreements to finance the acquisition of office equipment will expire at different years until 2008. These lease agreements qualify as capital leases for financial accounting purposes and, therefore, have been recorded at the present value of their future minimum lease payments as of the inception date. At June 30, 2003, the capitalized assets amounting to approximately \$205,245 are reported as equipment in the statement of net assets.

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2003 is as follows:

<u>Year ending June, 30</u>	<u>Principal</u>
2004	\$ 49,168
2005	49,168
2006	45,945
2007	39,501
2008	36
Total minimum lease payments schedule under agreements	<u>183,818</u>
Less: Amount representing future interest payments	<u>(24,483)</u>
Present value of minimum lease payments	159,335
Less:	
Current portion obligation under capital leases	38,434
Obligation under capital leases, excluding current portion	<u>\$ 120,901</u>

**11. COMMITMENTS AND CONTINGENCIES**

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgment.

With respects to pending or threatened litigation, the Municipality has reported liabilities of \$561,500 for awarded and anticipated unfavorable judgments as of June 30, 2003. This amount was reported within claims and judgments liabilities in the government-wide statement of net assets. Management believes that the ultimately liability in excess of amounts provided, if any, would not be significant.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
Notes to Basic Financial Statements  
June 30, 2003

**12. ACCOUNTING CHANGES AND RESTATEMENTS**

During current year, the Municipality implemented several new accounting standards and pronouncements issued by GASB.

GASB Statement No. 34, as amended by GASB 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the 2002 financial statements were required.

GASB Statement No. 38 requires certain note disclosures. The provisions of these new standards have been incorporated into the basic financial statements and notes.

GASB Interpretation No. 6 clarifies the application of existing standards for distinguishing the respective portions of certain types of liabilities that should be reported as (1) governmental fund liabilities and (2) general long-term liabilities of the Municipality. The provisions of this interpretation have been incorporated into the basic financial statements and notes.

These new accounting standards caused most of the accounting changes and restatements described on the ensuing discussions below. Changes and restatements for reasons other than the adoption of the above pronouncements are also explained below.

The following schedule reconciles the June 30, 2002 fund balances as previously reported by the Municipality to the beginning fund balances, as restated:

	June 30, 2002, fund balance as previously reported	Correction of accounting errors	June 30, 2002, fund balance (deficit) as restated
<b>Major funds:</b>			
General fund	\$ 2,057,540	\$ (211,931)	\$ 1,845,609
Debt service fund	835,639	320,066	1,155,705
HUD Section 108 fund	546,649	(47,763)	498,886
State legislative joint resolutions fund	1,243,512	(1,243,544)	(32)
	<u>4,683,340</u>	<u>(1,183,172)</u>	<u>3,500,168</u>
<b>Nonmajor funds:</b>			
Special revenue fund	985,022	(927,251)	57,771
Other capital projects fund	3,365,727	554,586	3,920,313
	<u>4,350,749</u>	<u>(372,665)</u>	<u>3,978,084</u>
<b>Totals</b>	<u>\$ 9,034,089</u>	<u>\$ (1,555,837)</u>	<u>\$ 7,478,252</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CANÓVANAS**  
**Notes to Basic Financial Statements**  
**June 30, 2003**

The following table reconciles certain liabilities reported in the June 30, 2002 general long-term debt account group (GLTDAG) the respective beginning long-term liabilities balances in the accompanying statement of net assets, as restated:

	<b>June 30, 2002, GLTDAG balance as previously reported</b>	<b>Correction of accounting errors</b>	<b>June 30, 2002, liabilities balances of statement of net assets, as restated</b>
Department of treasury loan	\$ 2,934,767	\$ (560,852)	\$ 2,373,915
HUD Section 108 loan	-	1,000,000	1,000,000
Obligation under capital leases	-	194,971	194,971
Reserve for federal cost disallowances	-	158,500	158,500
Compensated absences	1,084,798	815,054	1,899,852
Legal claims and judgments	100,000	101,500	201,500
Summer and christmas bonus	-	161,956	161,956
<b>Totals</b>	<b>\$ 4,119,565</b>	<b>\$ 1,871,129</b>	<b>\$ 5,990,694</b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS  
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND  
YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget - Positive (Negative)
	Original	Final		
<b>Revenues:</b>				
Property taxes	\$ 3,111,094	\$ 3,111,094	\$ 3,225,180	\$ 114,086
Municipal license taxes	2,040,000	2,956,644	3,276,412	319,768
Construction excise taxes	1,100,000	2,417,063	2,921,556	504,493
Intergovernmental contributions and reimbursements	4,016,400	4,079,022	3,990,317	(88,705)
Interest, fines and penalties	190,000	190,000	301,173	111,173
Charges for services	1,400,000	1,400,000	156,656	(1,243,344)
Other	418,901	1,208,065	5,198,108	3,990,043
	<u>\$ 12,276,395</u>	<u>\$ 15,361,888</u>	<u>\$ 19,069,402</u>	<u>\$ 3,707,514</u>
<b>Expenditures:</b>				
General government	\$ 6,441,874	\$ 9,449,921	\$ 10,515,982	\$ (1,066,061)
Urban and economic development	1,759,667	1,718,767	6,637,052	(4,918,285)
Public safety	298,907	248,909	430,024	(181,115)
Public housing and welfare	887,019	730,314	1,014,772	(284,458)
Culture, recreation and education	273,694	325,191	324,888	303
Health and sanitation	2,615,234	2,888,286	2,909,008	(20,722)
	<u>\$ 12,276,395</u>	<u>\$ 15,361,388</u>	<u>\$ 21,831,726</u>	<u>\$ (6,470,338)</u>

**Explanation of Differences:**

**Sources/inflows of financial resources:**

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 19,069,402
<b>Differences - budget basis to GAAP:</b>	
Adjustments to receivables to convert to modified accrual basis	(1,236,009)
Resources considered revenues for budgetary purposes but are not revenues for financial reporting purposes	(1,313,294)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(141,732)
Issuance of long-term debt and proceeds from sale of land are inflows of budgetary resources but are regarded as "other financing sources" for financial reporting purposes	<u>(4,075,000)</u>
<b>Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds</b>	<u><u>\$ 12,303,367</u></u>

**Uses/outflows of financial resources:**

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 21,831,726
<b>Differences - budget basis to GAAP:</b>	
Adjustments to payables to convert to modified accrual basis	(1,417,461)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(899,033)
Debt issue costs are outflows of budgetary resources but are not expenditures for financial reporting purposes	(13,025)
Resources considered expenditures for budgetary purposes but are not expenditures for financial reporting purposes	(3,230,726)
Encumbrances recorded as current year expenditures for GAAP basis	<u>(830,410)</u>
<b>Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds</b>	<u><u>\$ 15,441,071</u></u>

The accompanying notes to the basic financial statements are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
June 30, 2003**

	<u>Federal CFDA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
<b>U.S. Department of Housing and Urban Development</b>			
Lower Income Housing Program (Section 8 Voucher)	14.856	RQ-46V-07501	\$191,187
Housing Opportunities for Persons with AIDS	14.241	N/A	25,825
Community Development Grant/Entitlement Grant	14.218	B-98-MC-72-0018	14,891
		B-99-MC-72-0018	12,626
		B-00-MC-72-0018	82,162
		B-01-MC-72-0018	507,932
		B-02-MC-72-0018	476,689
<b>Loan Guarantee Section 108</b>	N/A	B-99-MC-72-0018*	2,873,499
Total U.S. Department of Housing and Urban Development			<u>4,184,811</u>
<b>U.S. Department of Health and Human Services</b>			
Passed through Governor's Office for Human Development - Child Care	93.575	N/A*	1,040,849
Total U.S. Department of Health and Human Services			<u>1,040,849</u>
<b>U.S. Department of Agriculture</b>			
Pass-through the Puerto Rico Elderly Commission Food Distribution	10.558	N/A	102,403
Total U.S. Department of Agriculture			<u>102,403</u>
<b>U.S. Department of Justice</b>			
Public Safety Partnership and Community Policing Grant (COPS)	16.710	2000SHWX0307	208,302
Proyecto Girasol	16.579	2001-DB-BX-0072	34,459
Municipal Police Equipment		2002-LB-BX-2449	<u>4,407</u>
Total Department of Justice			<u>247,168</u>
Passed through Governor's Office for FEMA			<u>9,556</u>
Total Federal Financial Assistance			<u>\$5,584,787</u>

\* Major Programs

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Year ended June 30, 2003

NOTE 1 - GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Canóvanas of the Commonwealth of Puerto Rico and is presented on the accrual basis of accounting. The Municipality of Canóvanas reporting entity is defined in Note 1 to the Municipality's basic financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in our used in the preparation of the basic financial statements.

NOTE 2 - RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS

Revenues and expenditures of the federal awards are included in the Municipality's basic financial statements within the Major and Nonmajor Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Expenditures in the basic financial statements:

Major Funds	\$19,783,077
Nonmajor Governmental Funds	<u>5,185,369</u>
	24,968,446
Less non-federal expenditures	<u>(19,383,659)</u>
Expenditures in the Schedule of Expenditures of Federal Awards	<u>\$5,584,787</u>

**NOTE 3- LOANS OR LOANS GUARANTEES**

Section 108 Loan Guarantee is included in the Statement of Net Assets within the long-term debt. Outstanding balance of the note payable to HUD at June 30, 2003, amounted to \$4,716,867.



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

To the Honorable Mayor  
and the Municipality of Canóvanas  
Canóvanas, Puerto Rico

We have audited the financial statements of the Municipality of Canóvanas of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2003, and have issued our report thereon dated December 17, 2003. 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 *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Canóvanas of the Commonwealth of Puerto Rico financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of 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 instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 03-15 thru 03-28.

Internal Control Over Financial Reporting

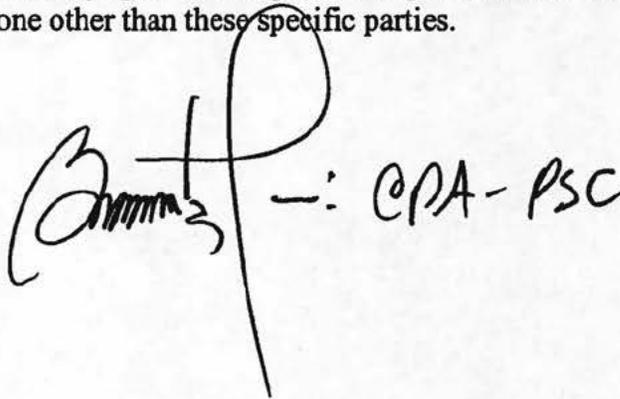
In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters, involving the 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 items 03 -1 thru 03-14.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 03-1 to be material weakness.

This report is intended solely for the information and use of the Municipality's management, municipal legislature, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specific parties.

Toa Alta, Puerto Rico  
December 17, 2003

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the original report.

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

To the Honorable Mayor  
and the Municipality of Canóvanas  
Canóvanas, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Canóvanas of the Commonwealth of Puerto Rico (the 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, 2003. Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality's management. Our responsibility is to express an opinion on 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; 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 Municipality's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Municipality's compliance with those requirements.

In our opinion, except for the instances of noncompliance disclosed below, the Municipality of Canóvanas, Commonwealth of Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 03-15 thru 03-28.

### Internal Control Over Compliance

The management of Municipality of Canóvanas, Commonwealth of Puerto Rico is responsible for establishing and maintaining effective internal control over compliance with the 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 con compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

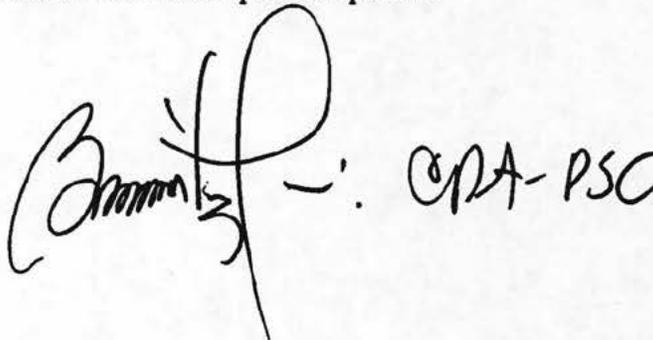
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 03-1 thru 03-14.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 03-1 to be material weakness.

This report is intended solely for the information and use of the Municipality's management, Municipal Legislature, 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.

Toa Alta, Puerto Rico  
December 17, 2003

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the original report.



Handwritten signature and initials: *Benitez-Jaime* - CPA-PSC

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANÓVANAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
June 30, 2003

**Section I - Summary of Auditors' Results**

**Financial Statements**

Type of auditors' report issued: Unqualified  
 Internal control over financial reporting:  
 Material weakness(es) identified?  yes  no  
 Reportable condition(s) identified  
 not considered to be material weakness?  yes  none reported  
 Noncompliance material to financial statements  
 noted?  yes  no

**Federal Awards**

Internal Control over major programs:  
 Material weakness(es) identified?  yes  no  
 Reportable condition(s) identified  
 not considered to be material weaknesses?  yes  none reported  
 Type of auditor's report issued on compliance  
 For major programs: Qualified  
 Any audit findings disclosed that are required  
 to be reported in accordance with  
 Circular A-133, Section .510(a)?  yes  no

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
N/A	Loan Guarantee Section 108
93.575	Pass-through Governor's Office for Human Development Child Care Program

Dollar threshold used to distinguish  
 Between Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee?  yes  no

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**Section II - Financial Statement Findings**

The current year findings and questioned costs were discussed with the Municipality's management which generally concurred with our comments and recommendations. The Municipality of Canóvanas will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

**03-1 ACCOUNTING SYSTEM**

The Municipality's current accounting system does not comply with requirements established in the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico and Law 81 of August 30, 1991. Such regulations provide, among other things that the municipal accounting shall be based on generally accepted accounting principles.

Also, the computerized accounting system should provide for financial information that will serve as the basis for the effective control of revenues, expenditures, property and investments, since this information is necessary for the preparation of reliable financial statements in accordance to generally accepted accounting principles. Finally, the Municipality is responsible for designing fiscal procedures for the system's operations and establishing proper internal controls for the purpose of preventing or minimizing irregularities.

The Municipality's accounting system only provides for the recording of revenues and expenditures and other limited transactions. In addition, the accounting records are not integrated, and a double entry system (debits and credits) is not used. Accounting records were maintained on

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a cash basis during the year and at end of year the corresponding adjustments were made to convert the records to the modified accrual basis. The conversion to the modified accrual basis requires a significant effort because the information has to be gathered from different informal accounting records. The system lacks the necessary supporting records for the preparation of financial statements in accordance with generally accepted accounting principles. Additionally, we noted that certain records in use were not adequately maintained or posted on a timely basis.

Due to the deficiencies above mentioned, the examination of the financial statements for the year ended June 30, 2003, was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made in order to account for unrecorded transactions, or to correct transactions recorded in the wrong accounting period. Since the accounts and other records are not designed to provide the information as is presented in financial statements, it was necessary to obtain such information from various departments and persons within the Municipality and from numerous accounting records which are not integrated.

#### 03-2 CASH AND BANK ACCOUNTS

The Municipality has not established sufficient controls in the handling of bank accounts to prevent errors and irregularities from being timely detected. The following control deficiencies were noted during our examination:

- a) The cash balance shown by the Municipality's Treasury Department for the Debt Service Fund as of June 30, 2003, did not agree with the notification of the Account Activity of the Municipal Revenues Collection Center, known by its Spanish acronym as CRIM. This is due to transactions for the fiscal year which were not recorded for in the Municipality's books.

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Although such information was received late from the CRIM, the Municipality had not closed the books at that date and such transactions could have been properly recorded.

**RECOMMENDATION:**

We recommend that transactions affecting funds held by the CRIM for the Municipality's Debt Service Fund should be recorded on a timely basis and balances reconciled periodically, especially at year end.

- b) Checks totaling \$2,098, as of June 30, 2003, have been outstanding for more than one year. The bank reconciliation are the following:

<u>Account Name</u>	<u>Account Number</u>	<u>Amount</u>
- Cuenta Regular	119-831023	\$714
- Cuenta Nómina	119-039273	<u>1,384</u>
		<u>\$2,098</u>

- c) Reconciling items or differences have been outstanding for more than one year without adequate explanation. The bank reconciliations are the following:

<ul style="list-style-type: none"> <li>- Cuenta corriente</li> <li>- Cuenta Nómina</li> <li>- Cash concentration</li> <li>- Donaciones gericola</li> </ul>	<ul style="list-style-type: none"> <li>- Aportación Child Care</li> <li>- SBGP</li> <li>- Section 108</li> <li>- Envejecientes gericola</li> </ul>
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RECOMMENDATION:

The Municipality should improve its control procedures over bank reconciliations to record the necessary adjustments when there are outstanding checks for more than one year. Stop payments should be issued to cancel checks outstanding over twelve months. Such checks should be substituted with new checks and deposited in the appropriate accounts in order to make the funds available to the Municipality.

All bank accounts shall be reconciled every month and all reconciling differences, if any, must be investigated and adjusted, accordingly.

03-3 LONG-TERM DEBT

The Municipality does not maintain adequate records of its outstanding long-term obligations, and consequently, solely relies on the notifications from the Government Development Bank for Puerto Rico to acknowledge and record the balance of the outstanding debt and the amounts needed to fund its debt service.

RECOMMENDATION:

The Municipality should design a system and establish adequate procedures to maintain accounting records of its outstanding long-term obligations. These records will be used to verify the correctness of the amounts informed by the CRIM for the Municipality's Debt Service Fund under the custody of the Government Development Bank for Puerto Rico and the outstanding balance of the long-term debt.

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03-4 INTERNAL AUDIT DEPARTMENT

Although the Municipality has established the an Internal Audit Office, its functions have been limited to minor areas since the auditor position was uncovered for 10 out of the 12 months of the 2002-2003 fiscal year. Mostly, the internal auditor's work has been limited to preparing the annual audit plan covering certain operating activities of the Municipality.

The main purpose of an Internal Audit Office is to review the various systems and activities and report on weaknesses and deviations from prescribed procedures. This is necessary even in the best managed organizations because organizations change over time and employees have a tendency to forget or ignore the required way of doing things. Also, procedures that were satisfactory at one time may no longer be adequate.

RECOMMENDATION:

We recommend the Municipality to restructure its Internal Audit Department in order to schedule the internal auditor's work in such a way that all major activities and federal programs of the Municipality are audited on a timely basis. To accomplish this objective, the Director of the Internal Audit Department must prepare:

- An audit plan covering all operating and financing activities of the Municipality on an annual basis
- Time schedules for each area to be audited
- Audit programs for each assignment

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03-5 BIDDING PROCEDURES

As part of our procurement procedures test, we selected 4 files representing 30% of the bids performed during the fiscal year. The following summarizes the exceptions noted.

- One file did not include the bid bond required for the construction contracts.
- Two files did not include the workmen compensation documentation as required by the municipal law.

RECOMMENDATION:

We recommend the Municipality to improve existing procedures in order to comply with prescribed procedures according to the Regulation on Basic Standards.

03-6 INTERFUND TRANSACTIONS

The Municipality does not maintain adequate control over interfund transactions. Cash transferred between funds is recorded as revenue in the receiving fund and as an expenditure in the disbursing fund. Several adjustments were made to reconcile such interfund transactions and properly account for these transfers as interfund receivables or payables.

RECOMMENDATION:

We recommend that adequate control procedures be established to assure proper accountability of interfund transactions. These procedures should be designed to properly segregate cash transferred on a loan basis from cash which represents revenue to the program since these transactions have different accounting treatment for financial statement presentation.

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03-7 ACCOUNTS PAYABLE AND ENCUMBRANCES

Under the Municipality's current accounting system, there is no adequate segregation between items representing actual accounts payable and those representing encumbrances because the liability is recognized when the purchase order is issued.

RECOMMENDATION:

The Municipality should establish procedures to clearly distinguish between encumbrances and amounts actually owed for goods and services received at year end. Governmental generally accepted accounting principles required that purchase orders issued for which the goods or services have not been received at year end be reported as an encumbrance, while the goods or services received but not paid at year end be recorded as a liability.

03-8 CASH MANAGEMENT

The OMB Common Rule requires that grantees' cash management system includes administrative procedures to minimize the time elapsing between the transfer of federal funds and the disbursement of these by the grantee. When advances of funds are made by the letter of credit method, funds shall be disbursed not later than three days after the date of the drawdown.

Although the Municipality has established procedures to ensure compliance with the above requirement, our disbursement test revealed instances in which disbursements were made several weeks after the funds were received.

RECOMMENDATION:

We recommend that the Municipality's management to instruct the Federal Programs personnel to strictly follow the established procedures regarding cash management requirements.

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03-9 MUNICIPAL LICENSE TAX

We selected 40 municipal license taxpayers files amounting to \$723,840 for examination, that represents 22% of total tax collected.

The following deficiencies were noted during our test:

- In 11 (28%) municipal license taxpayers files examined amounting to \$511,694, the municipal license issued were not present in file.
- In 8 (20%) municipal license tax payer files amounting to \$143,518, the income section of the volume of business tax return was not properly supported, including 3 files which volume of business exceeded \$1,000,000 and did not include the required audited financial statements.
- In 7 (18%) municipal license tax payer files amounting to \$120,011, did not include any evidence documenting follow up on collection efforts.
- In 1 (3%) the municipal license tax payer files amounting to \$814, was not available for examination.
- In 39 (98%) municipal license taxpayer files amounting to \$698,469, did not include the "Modelo 5 - Registro de Patentes de Industria y Comercio" as required by the regulations.
- In 2 (5%) municipal license tax payer files amounting to \$26,819, the reported volume of business per tax return differs from the amount recorded per the municipal license register.

**RECOMMENDATION:**

The Municipality should improve its control procedures to ascertain that municipal license tax files should contain sufficient information and documentation to support the reason for issuing or denying a gross volume of business license certificate.

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**03-10 DISBURSEMENT TEST**

As part of our test of cash disbursements during the year (amounting to approximately \$38.8 million), we selected 40 disbursement vouchers amounting to \$752,149 representing 2% of the total disbursements. The following deficiencies were noted during our examination:

- In 30 (75%) disbursement vouchers amounting to \$464,286, the supporting documentation, including the invoice were not stamped as paid to prevent or minimize duplicate payments.
- In 2 (5%) disbursement vouchers amounting to \$26,901, the disbursement voucher information did not agree to the "Modelo 25 - Registro de Libramiento" information.
- In one (3%) disbursement voucher amounting to \$120, we noted that the expenditure was recorded in "Modelo 26" - Orders and Contracts Book, without budget balance available on the expenditure item for the purchase order.
- In 2 (3%) disbursement voucher amounting to \$1,376, the disbursement did not have the proper accounting distribution.
- In 40 out of 40 (100%) disbursement vouchers amounting to \$752,149, the disbursement could not be traced to Models 3 and 28, since they were not prepared during the fiscal year.
- In 18 (45%) disbursement vouchers amounting to \$560,195, pertaining to special funds could not be traced to Model 26 - Orders and Contracts Book since it is not prepared for the special funds.

According to the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico, the pre-auditing unit or person in charge of pre-auditing the documents shall keep a record of the authorized signatures of the Municipality. He shall check against such record to ascertain that the officers certifying the documents are so authorized. He shall check the documents correctness in all of its parts and that the transactions in order to pursuant the correct legislation, ordinances, resolutions, contracts and regulations. Once everything is found to be in order, the document shall be certified as preaudited and shall be sent for the approval of the Finance Director. In addition, of the aforementioned regulation, the vouchers, all canceled checks and any other document, that

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justifies a payment, shall be filed by the Finance Director to be audited by the Puerto Rico Comptroller's Office or any other agency as required by law.

**RECOMMENDATION:**

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the process of acquisition of materials and supplies, equipment, and construction and service contracts.

**03-11 PERSONNEL FILES AND RELATED PAYROLL PROCEDURES**

The Municipality does not have an effective system to ensure the completeness and accuracy of the employee files in the personnel department. During our audit, we tested a sample of 40 employee files and noted that several files lacked nonstatutory deduction authorizations and other documentation supporting the employee's salary. The following exceptions were noted during our examination:

Seminars and training records	13 files	33%
Negative penal record certification	6 files	15%
Copy of social security card	4 files	10%
Job description	27 files	68%
Birth certificate	1 file	2%
Medical examination	1 file	2%
Employee evaluations	8 files	20%
Documents related to the retirement plan	2 files	5%

**RECOMMENDATION:**

The Personnel Department should review each employee file and ascertain their completeness. Management could design a standard checklist where the file reviewer could

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determine if documents are missing from each file. Signed exemptions certificates and authorizations for non -statutory withholdings should always support the amounts withheld from employees.

**03-12 CASH RECEIPT TEST**

As part of our test of cash receipts during the year (amounting to approximately 33 million), we selected 40 receipts amounting to \$3,399,000 representing 10% of the total receipts. The following deficiencies were noted during our examination:

The following reports were not prepared nor maintained during the 2002-2003 fiscal year:

- "Modelo 3 - Informe diario de Clasificación y Fondos Municipales"
  - "Modelo 28 - Informe Mensual"
- 2 (5%) cash receipts forms selected for examination amounting to \$85, did not agree with the amount recorded in the Program general ledger.
- 2 (5%) cash receipt forms amounting to \$24, were not available for examination.

According to Law 81, the books, documents and funds in the possession of the collectors must remain available for examination by Officers from the Office of the Comptroller, the Treasury Department, the Administration or any other duly authorized agency.

**RECOMMENDATION:**

The Municipality should enforce strict compliance with the procedures prescribed by the Revised Regulation on Basic Standards for the Municipalities of Puerto Rico during the revenues and cash receipts cycle.

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**03-13 INACTIVE AND UNNECESSARY FUNDS AND INACTIVE BANK ACCOUNTS**

The Municipality is maintaining an excessive number of funds and bank accounts that have been inactive for a long period. The accounting records include over 123 different funds, many of which have been inactive or had insignificant movement on operations during the year under audit.

This situation results from the need to analyze and close inactive funds and bank accounts when the fund's objective has been achieved or are no longer of significance. The internal control structure should provide for the accurate maintenance of the books, records, funds and accounts necessary to carry out the Municipality's operations.

**RECOMMENDATION:**

The Municipality should close all unnecessary and inactive funds or accounts. Budgetary balances or deficits, remaining in those funds should be investigated and properly closed as established by law.

**03-14 INTEREST AND OVERDRAFT CHARGES INCURRED**

The Municipality does not have adequate control over its cash disbursements to avoid incurring interest costs and bank overdraft charges. The Municipality incurred interest and overdraft charges in its Section 108 account in the amount of \$21 for the year ended June 30, 2003.

This situation occurs because the Municipality does not effectively monitor its cash balances before issuing payments, thus resulting in bank overdraft charges and interest costs.

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**RECOMMENDATION:**

The Municipality should maintain control over its bank account balances in order to minimize overdrafts that will result in the assessment of interest and overdraft charges. This can be achieved by monitoring the daily bank balances and by authorizing the payment of invoices when funds are available.

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
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**Section III - Federal Award Findings and Questioned Costs**

Section 8-Voucher  
CFDA No. 14.156  
RQ-46-V075-002-004

**03-15 FEDERAL CASH MANAGEMENT SYSTEM**

**Statement of Condition:**

The Municipality has not established effective cash management procedures. The program had an average cash balance of \$52,397 during the fiscal year. There were months which reported balances as high as \$59,845, at the end of the month.

NONE

**Criteria:**

Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Program's immediate cash needs.

**Recommendation:**

In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely and possible to the actual disbursements.

**03-16 REPORTING REQUIREMENTS**

**Statement of Condition**

In our review of the Requisition for Partial Payment of Annual Contribution, Form HUD-52663, we noted that it was submitted 3 days after the required submission date.

NONE

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
	<p>Criteria:</p> <p>According to HUD Handbook 7420.10, the PHA must submit Form HUD-52663 to the HUD Financial Management Center annually, 90 calendar days before the beginning of the PHA's fiscal year.</p> <p>Recommendation:</p> <p>The Municipality should improve existing procedures to ensure the timely submission of the Requisition for Partial Payment of Annual Contribution, Form HUD-52663, in order to comply with Federal regulation.</p> <p>The Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation. Also, the Municipality's management should establish adequate controls over the federal financial reports in order to provide for written evidence of the compliance with the filing requirement.</p> <p><b>03-17 REPORTING REQUIREMENTS</b></p> <p>Statement of Condition:</p> <p>In our review of the Supporting Data for Annual Contribution, Form HUD-52672 and the Estimate of Total Requirement Annual Contribution, Form HUD-52673, we noted that they were submitted 3 days after the required date.</p>	NONE

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
	<p>Criteria:</p> <p>According to HUD Handbook 7420.10 the PHA must submit Forms HUD-52672 and HUD-52673 to the HUD Financial Management Center annually, at least 90 calendar days before the beginning of the PHA's fiscal year.</p> <p>Recommendation:</p> <p>The Municipality should improve existing procedures to ensure the timely submission of the Supporting Data for Annual Contribution , Form HUD-52673, in order to comply with Federal regulation.</p> <p>The Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation. Also, the Municipality's management should establish adequate controls over the federal financial reports in order to provide for written evidence of the compliance with the filing requirement.</p>	
<p>SBGP 1986 CFDA No. 14.228 All Program Years</p>	<p><b>03-18 FEDERAL MANAGEMENT SYSTEM</b></p> <p>Statement of Condition:</p> <p>The Municipality has not established effective cash management procedures. The Program had an average cash balance of approximately \$25,047, during the fiscal year. There were months which reported balances as high as \$43,014.</p>	<p>NONE</p>

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
	<p>Criteria:</p> <p>Federal Regulation required that grantees shall conform to the standards applicable to advances from Federal Agencies. Amounts requested should be limited to the Program's immediate cash needs.</p> <p>Recommendation:</p> <p>In accordance with Federal Regulations, the Municipality should estimate drawdown of Federal funds as closely as possible to the actual disbursements.</p>	
UMTA CFDA NO. 20.500 PR 90-X071	<p><b>03-19 FEDERAL CASH MANAGEMENT SYSTEM</b></p> <p>Statement of Condition:</p> <p>The Municipality has not established effective cash management procedures. The program has an average cash balance of \$8,288, during the fiscal year.</p> <p>Criteria:</p> <p>Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.</p> <p>Recommendation:</p> <p>In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.</p>	NONE

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>						
	<b>03-20 INADEQUATE DOCUMENTATION OF PROVIDERS FILES</b>							
Child Care CFDA NO. 93.575	<p>Statement of Condition:</p> <p>As part of our eligibility test to providers of the Child Care Program, we selected a sample of 40 providers. The following documents were not available for examination:</p> <table border="0" style="margin-left: 40px;"> <tr> <td>a. Copy of social security card</td> <td style="text-align: right;">1 file</td> <td style="text-align: right;">3%</td> </tr> <tr> <td>b. House inspection</td> <td style="text-align: right;">1 file</td> <td style="text-align: right;">3%</td> </tr> </table> <p>Criteria:</p> <p>According to the contract agreement and the eligibility criteria for selecting providers, the service providers must submit two health certificates, two birth certificates, two certificates of no penal records and the social security card. Also, the provider shall sign a certification statement stating that the development of grant activity will be drug and alcohol free.</p> <p>Recommendation:</p> <p>The Municipality should implement a checklist to be used for each provider file to assure completeness of the required documentation, and perform follow-up procedures in order to update such files. This may help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowance.</p>	a. Copy of social security card	1 file	3%	b. House inspection	1 file	3%	NONE
a. Copy of social security card	1 file	3%						
b. House inspection	1 file	3%						



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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
Child Care CFDA NO. 93.575	<b>03-22 FEDERAL MANAGEMENT SYSTEM</b>  Statement of Condition:  The Municipality has not established effective cash management procedures. The program has an average cash balance of \$278,678, during the fiscal year. There were months which reported balances as high as \$708,601, at the end of the month.  Criteria:  Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.  Recommendation:  In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.	NONE
CDBG 1999 CFDA No. 14.218 B-99-MC-72-0018	<b>03-23 INADEQUATE DOCUMENTATION OF PARTICIPANT FILES</b>  Statement of Condition:  As part of our test to determine whether the grantee assure that the rehabilitation work is properly completed, we selected a sample of 15 participants. The following documents were not available for examination:	NONE

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>		<u>Questioned Costs</u>
a. Letter notifying the owner the selection to the program.	1 File		7%
b. Evidence of performed payments	5 Files		33%
c. Evidence of the delivery of materials	8 Files		53%
d. Detail of expenses incurred	1 Files		7%
e. Photos of the residence prior to the repair	1 File		7%
f. Inspection report during and after the repair	14 Files		93%
g. Follow-up visits	12 Files		80%

**Criteria:**

According to 24 CFR, 570.506 the grantee must assure that the work is properly completed. For each residential rehabilitation activity the following records are needed:

- a) Re-habilitation contract describing the deficiencies in each structure to be corrected.
- b) An inspection of the rehabilitation work upon completion to assure that it was carried out in accordance with contract specifications.

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
	<p>Recommendation:</p> <p>The Municipality must inspect the rehabilitation work upon completion to assure that it is carried out in accordance with the contract specifications.</p>	
CDBG 2002 B-02-MC-72-0018 CFDA No. 14.218	<p><b>03-24 DAVIS-BACON ACT</b></p> <p>Statement of Condition:</p> <p>As part of our audit tests we selected 1 weekly payroll from the following construction project:</p> <ul style="list-style-type: none"><li>• Repavimentación Calles 4, 5, 6 y Juan Félix, Barrio San Isidro</li></ul> <p>The following exceptions were noted during our examination:</p> <ol style="list-style-type: none"><li>a. There was no evidence that employee interviews were performed during the period.</li><li>b. Project file did not include any documentation evidencing the request of the determination of project prevailing wages for the fiscal year 2002-03.</li><li>c. Construction contract did not contain the clause related to the payment of prevailing wages.</li></ol> <p>Criteria:</p> <p>According to HUD Handbook:</p> <p>Contractor weekly payrolls and other basic records should be reviewed during routine compliance enforcement activity on every construction project. Submitted payrolls shall be examined to assure compliance with the labor standards. Also, a</p>	NONE

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<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
	<p>preconstruction conference must be held to explain labor standards.</p> <p>Recommendation:</p> <p>The Municipality should establish procedures to ascertain that all documents submitted by the contractor are reviewed and approved on a timely basis to ensure compliance with labor standards.</p>	
<p>Section 108 B-01-MC-72-0018</p>	<p><b>03-25 DAVIS-BACON ACT</b></p> <p>Statement of Condition:</p> <p>As part of our audit tests we selected 1 weekly payroll from the following construction project:</p> <ul style="list-style-type: none"><li>- Construcción de Edificio Multiuso y Estacionamiento</li></ul> <p>Then following exceptions were noted during our examination:</p> <ul style="list-style-type: none"><li>(a) There was no evidence that employee interviews were performed during the period.</li><li>(b) Project file did not include any documentation evidencing the request of the determination of project prevailing wages for the fiscal year 2002-03.</li><li>(c) Construction contract did not contain the clause related to the payment of prevailing wages.</li></ul>	<p>NONE</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANOVANAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
June 30, 2003

<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
	<p>Criteria:</p> <p>According to HUD Handbook:</p> <p>Contractor weekly payrolls and other basic records should be reviewed during routine compliance enforcement activity on every construction project. Submitted payrolls shall be examined to assure compliance with the labor standards. Also, a preconstruction conference must be held to explain labor standards.</p> <p>Recommendation:</p> <p>The Municipality should establish procedures to ascertain that all documents submitted by the contractor are reviewed and approved on a timely basis to ensure compliance with labor standards.</p>	
FEMA 1247 CFDA NO. 83.544	<p><b>03-26 FEDERAL MANAGEMENT SYSTEM</b></p> <p>Statement of Condition:</p> <p>The Municipality has not established effective cash management procedures. The program had an average cash balance of \$33,005, during the fiscal year.</p> <p>Criteria:</p> <p>Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.</p>	NONE

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CANOVANAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
June 30, 2003

<u>Program</u>	<u>Findings/Noncompliance and Recommendations</u>	<u>Questioned Costs</u>
Pass-through the Puerto Rico Elderly Commission Food Distribution CFDA No.10.558	<p>Recommendation:</p> <p>In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.</p> <p><b>03-27 FEDERAL MANAGEMENT SYSTEM</b></p> <p>Statement of Condition:</p> <p>The Municipality has not established effective cash management procedures. The program had an average cash balance of \$161,485, during the fiscal year. There were months which reported balances as high as \$174,565, at the end of each month.</p> <p>Criteria:</p> <p>Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.</p> <p>Recommendation:</p> <p>In accordance with Federal regulations, the Municipality should estimate drawdowns of Federal funds as closely as possible to the actual disbursements.</p>	NONE





*Dependencias Municipales*

*Estado Libre Asociado de Puerto Rico*  
**Gobierno Municipal  
de Canóvanas**

*PO Box 1612*  
*Canóvanas, Puerto Rico 00729-1612*  
*Tel. (787) 876-2328 • Fax: (787) 256-7269*

December 22, 2003

Benítez Jaime, CPA-PSC  
P.O. Box 191503  
San Juan, Puerto Rico 00919-1503

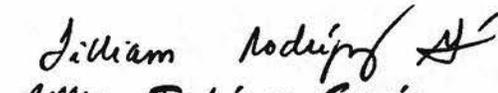
Dear Auditors:

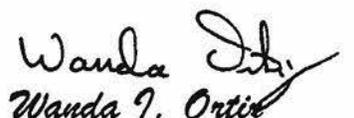
We have received the Schedule of Findings and Questioned Costs, included in the Single Audit Report of the Municipality of Canóvanas for the year ended June 30, 2003.

Although we have already discussed the above mentioned findings, (Financial Statements and Federal Awards Findings) we are in the process of gathering all the relevant information and preparing the related responses. In order to comply with OMB Circular A-133, after the completing this task we are going to issue our corrective actions taken on all prior audit findings directly to the grantors and required government agencies.

Cordially,

  
*José R. Soto Rivera*  
Mayor

  
*Lilliam Rodríguez García*  
Finance Director

  
*Wanda T. Ortiz*  
Federal Programs Director

## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2002. Under the heading Corrective Action Taken there will be the following:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2002-2003).

NR - Not resolved yet. Finding repeated in fiscal year 2002-2003.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
02-1	Accounting System	NR
02-2	Cash and Bank accounts	NR
02-3	Long-term debt	NR
02-4	Internal Audit Department	NR
02-5	Fixed Assets	NR
02-6	Interfund transactions	NR
02-7	Accounts payable and encumbrances	NR
02-8	Cash management	NR
02-9	Municipal license tax	NR
02-10	Disbursement test	NR
02-11	Personnel files and related payroll procedures	NR
02-12	Cash receipts test	

## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2002. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2002-2003).
- NR - Not resolved yet. Finding repeated in fiscal year 2002-2003.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
02-13	Inadequate Property Records	NR
02-14	Federal Cash Management System	NR
02-15	Reporting Requirements	NR
02-16	Federal Reporting	NR
02-17	Reporting Requirements	NR
02-18	Federal Management System	NR
02-19	Federal Management System	NR
02-20	Inadequate Documentation of Providers Files	NR
02-21	Inadequate Documentation of Participants Files	NR
02-22	Federal Management System	NR
02-23	Federal Management System	NR

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
02-24	Inadequate Documentation of Participant Files	NR
02-25	Davis-Bacon Act	NR
02-26	Davis-Bacon Act	NR
02-27	Federal Management System	NR
02-28	Federal Management System	NR
02-29	Federal Management System	NR

## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2001. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2002-2003).
- NR - Not resolved yet. Finding repeated in fiscal year 2002-2003.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
01-1	Accounting System	NR
01-2	Cash and Bank accounts	NR
01-3	Long-term debt	NR
01-4	Internal Audit Department	NR
01-5	Fixed Assets	NR
01-6	Financial Reporting	FR
01-7	Interfund transactions	NR
01-8	Accounts payable and encumbrances	NR
01-9	Cash management	NR
01-10	Municipal license tax	NR
01-11	Disbursement test	NR
01-12	Personnel files and related payroll procedures	NR

## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2001. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2002-2003).
- NR - Not resolved yet. Finding repeated in fiscal year 2002-2003.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
01-13	Accounting System	NR
01-14	Inadequate Property Records	FR
01-15	Federal Cash Management System	NR
01-16	Requisition for Partial Payment of Annual Contributions	NR
01-17	Federal Reporting	NR
01-18	Supporting Data for Annual Contribution	NR
01-19	Federal Management System	NR
01-20	Federal Management System	NR
01-21	Federal Management System	NR
01-22	Reporting Requirement	FR
01-23	Federal Management System	NR
01-24	David - Bacon Act	FR

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
01-25	Federal Cash Management System	NR
01-26	Inadequate Documentation of Providers Files	NR
01-27	Inadequate Documentation of Participant Files	NR
01-28	Federal Management System	NR
01-29	Federal Cash Management System	NR
01-30	Federal Cash Management System	NR
01-32	Inadequate Documentation of Participant Files	NR
01-33	Contract Provision - Davis Bacon Act	NR
01-34	Davis-Bacon Act	NR
01-35	Federal Cash Management System	NR
01-36	Federal Cash Management System	FR
01-37	Federal Cash Management System	NR
01-38	Federal Cash Management System	NR
01-39	Federal Cash Management System	NR