

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

MUNICIPIO DE CAROLINA
AUDITORIA 2002-2003
30 DE JUNIO DE 2003

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DE ASUNTOS MUNICIPALES
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**MUNICIPALITY OF CAROLINA
CAROLINA, PUERTO RICO**

**FINANCIAL STATEMENTS WITH THE
INDEPENDENT AUDITOR'S REPORT THEREON
JUNE 30, 2003**

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Auditors and Consultants

1056 Muñoz Rivera Avenue
Suite 304
San Juan, PR 00927-5013
Telephone: (787) 754-6615
Telefax: (787) 765-9405
E-Mail: pkfpr@pkfpr.com

INDEPENDENT AUDITOR'S REPORT

Hon. Jose E. Aponte de la Torre and
Members of the Municipal Assembly of the
Municipality of Carolina
Carolina, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business type activities, major funds and the remaining fund information of the Municipality of Carolina as of and for the fiscal year ended June 30, 2003, which collectively comprise the Municipality's financial statements. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the June 30, 2003 financial statements of the Employment Opportunity Municipal Agency (AMOE), which represents .6 percent and 4.5 percent of the assets and revenues of the Municipality of Carolina. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for AMOE, is based on the report of the other auditors. The financial statements of the Municipality of Carolina as of June 30, 2002 were audited by other auditors whose report dated December 20, 2002 expressed a qualified opinion on those statements.

Except as explained in the following paragraph, 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 the Government Auditing Standards, issued by the Controller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in note 9 to the financial statements, the Municipality has substantially completed the process of identifying and valuing the investment in general capital assets. However, some differences have been identified in total personal property when compared to the accounting records and are being corrected. We were unable to satisfy ourselves about the correctness of personal property balance at June 30, 2003.

Pannell Kerr Forster, LLP

Hon. Jose E. Aponte de la Torre and
Members of the Municipal Assembly of the
Municipality of Carolina

In our opinion except for the effects, if any, on the uncertainty to the differences among investment in general capital assets and accounting records that are being corrected on the governmental activities as described in the third paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, business-type activities, major funds and remaining fund information of the Municipality of Carolina, as of June 30, 2003, and the changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis information, on pages I through XIV, and budgetary comparison information on page 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



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January, 27, 2004
San Juan, Puerto Rico

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a Management Discussion and Analysis of The Autonomous Municipality of Carolina (herein after "the Municipality") financial performance, providing an overview and comparison of the financial activities for the fiscal years ended on June 30, 2003 and 2002. This narrative overview and analysis is a new format prescribed by the provisions of Government Accounting Standards Board Statement 34 (GASB 34). We encourage readers to consider the information presented here in conjunction with the Municipality's basic financial statements.

Because fiscal year ended June 30, 2003 represents the second year in which the Municipality implemented the provisions of the GASB Statement No. 34, this discussion and analysis provides comparisons with the previous fiscal year. However, in future years, comparisons will be more significant and will go further in explaining the Municipality's financial position. For fiscal years ended on June 30, 2003 and 2002 operations sustain the Municipality's track of solvency and sound fiscal conditions. The Governmental Wide financial statements also support our statement.

FINANCIAL HIGHLIGHTS

- The Municipality's net assets reported in the Government-Wide financial statements as of June 30, 2003 resulted in \$245.9 millions, that represents an increase of \$57.2 millions (23%) as compared with last fiscal year. Of this amount \$9.6 millions are unrestricted. Net assets may be used to meet the Municipality's current operations.
- The results of activities recorded in the Government Wide financial statements resulted an increase in net assets of \$50 millions (127 %) as compared with last fiscal year.
- The cost of all Municipality's functions were \$140.6 and \$131.3 millions, for fiscal year ended June 30, 2003 and 2002, respectively.
- As June 30, 2003 the Municipality's General Fund (the primary operating fund) reported in the Fund Financial Statements reflected a fund balance of \$ 47.1 millions, an increase of \$10.7 millions (29%) in comparison with the prior year.
- The total unrestricted cash recorded in the Fund Financial Statements was \$99.9 millions, an increase of \$17 millions (20%) as compared with last fiscal year. The investments in certificates of the deposits were \$94.2 and \$78.2 millions, for fiscal year ended June 30, 2003 and 2002, respectively.

- Loans principal payments were \$11 millions during current and previous fiscal years. Loan proceeds from new debt issued amounted to \$59.4 millions during the fiscal year 2002-03.
- Due to the continuous increase of financial resources The Municipal Legislature revised the Municipality's Budget several times increasing the original budget by \$39.1 millions. The total revised budget for fiscal years ended June 30, 2003 and 2002 amounted to \$245.7 and \$224.2 millions, respectively.
- Fiscal year 2003 expenditures from general fund showed a favorable variance of \$8.3 millions, as compared with the budgeted amount.
- During current fiscal year, the municipality was able to acquire a Recycle Plant amounting to \$8 million. This investment will increase the remaining life of the landfill operations.
- The Municipality received from the state real property donated contribution for recreational parks amounted to \$38.7 millions, during fiscal year.

New Requirements for the Financial Reporting

The new approach on the preparation of the Municipality's financial statements emphasizes on a government wide (consolidated) view of its financial operations. Nevertheless major individual funds are presented and evaluated in all of its details. Simultaneous implementation of both of these perspectives allows users to address relevant questions about municipality's performance and provides a basis for comparisons and evaluation of services quality.

New reporting standards, required comparisons with prior years data. This narrative report provides a better understanding of the municipality's financial positions and results of its operations.

Financial Statements Components

The discussion and analysis is an introduction to the Municipality's basic financial statements, which comprise three components: 1) Government-Wide Financial Statements, 2) Fund Financial Statements, and 3) Notes to the Financial Statements that provides more details. This report also contain budgetary comparison schedule that include a reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General fund as presented in the Municipality's basic financial statements. These components are described below:

Government-Wide Financial Statements

These financial statements present the financial position of the Municipality from the economic resources measurement focus using the accrual basis of accounting. In addition, these financial statements include all assets of the Municipality (including infrastructure) as well as all liabilities (including long-term debt). Certain eliminations have been made in regards to interfund activity, payables and receivables.

The Statement of Net Assets and Statement of Activities are two financial statements that report information about the Municipality and its activities that should help answer this question: Is the Municipality better off or worse off as result of this year activities?

The Statement of Net Assets reports information of the municipality as a whole. Those statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private sector companies. Accrual of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets (page V) present all of the Municipality's assets and liabilities with the difference between the two reported as "net assets". Over time, increase and decrease in net assets is an indicator of whether the Municipality's financial position is improving or deteriorating. Other factors to consider are changes in the Municipality's property tax base and the condition of the Municipality's roads.

The Statement of Activities is focused on both the gross and net cost of various activities, which are supported by the Municipality's property tax, municipal license tax and other revenues. It is intended to summarize and simplify the user's analysis of the costs of governmental services. The governmental activities reflect basic services, including public safety, public works, solid waste disposal, community services, health and general government services. Property tax, municipal license tax, construction and permits tax, state and federal grants, and interest income finance most of these activities.

The Statement of Activities (page VI) presents information showing how the Municipality's net assets changed during the most recent fiscal year. All the changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only results in cash flows in future fiscal periods.

These two statements report the Municipality's net assets and changes in them. Net assets are the difference between assets and liabilities, which is one way to measure the Municipality's financial health, or financial position.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the major individual funds. Some funds are required to be established by State law and by bond covenants. However, management establishes many other funds to help control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other monies. 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 Major Governmental Funds presentation provides detailed information about the most significant funds, not the Municipality as a whole.

The Municipality uses fund accounting to ensure and demonstrate compliance with financial related legal requirements. The Municipality's basic services are reported in governmental funds, which focus on how money flows in and out of these funds and the balances at the end of the year that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental funds statement provides a detailed short-term view of the Municipality's general governmental operations and the basic services it provides. Governmental funds information help you determine whether there are more or fewer financial resources that can be spend in the near future to finance Municipality's programs. The differences of results between governmental activities and governmental funds are explained in a reconciliation schedule following each governmental fund financial statement.

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Since the budgetary basis differs from actual amounts for the general fund in the accompanying Statement of Revenues and Expenditures – Budget and Actual is presented on the budgetary basis to enhance comparability. Comparison schedule for general fund include changes and variations between the original and final budget, and explanation of any reasons for significant changes in actual results affects the general fund of the Municipality.

The Municipality's Fund Financial Statements begin on page XI and included all Governmental funds for fiscal years ended June 30, 2003 and 2002.

Infrastructure Assets

The Municipality implemented the major model portions of GASB statement 34 during the current fiscal year. The infrastructure portion was deferred to be implemented when ready to address the modified approach, but no later than the 2005-06 dead line. Historically, the governmental larger group of assets have not been reported nor depreciated in governmental financial statements.

The new statement requires that this asset be valued and reported within the Governmental column of the Governmental-Wide Statements. Additionally, the government must elect to either depreciate these assets over their estimated useful life or develop a system of asset management designated to maintain the service delivered potentially to near perpetuity. If the government develops the assets management system, which periodically, by category, measures and demonstrate its maintenance of locally established level 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 statements users in evaluating a local government and its performance over time.

Government -Wide Statement

Statement of Net Assets

The Statement of Net Assets reports information of the municipality as a whole. Increase or decrease of net assets may serve as an indicator of whether municipality's financial position is improving or deteriorating. The Municipality's net assets increase by \$57.2 millions at the close of the recent fiscal year. The following reflects the comparative condensed Statement of Net Assets.

Comparative Condensed Statement of Net Assets As of June 30, 2003 and 2002

| | <u>June 30, 2003</u> | <u>June 30, 2002</u> |
|---|----------------------|----------------------|
| Current assets | \$235,184,667 | \$200,064,805 |
| Capital Assets | <u>294,575,279</u> | <u>242,475,827</u> |
| Total assets | <u>\$529,759,946</u> | <u>\$442,540,632</u> |
| | | |
| Current liabilities | \$ 70,028,375 | \$ 82,548,672 |
| Long-term liabilities | <u>213,838,614</u> | <u>171,323,996</u> |
| Total liabilities | <u>\$283,866,989</u> | <u>\$253,872,668</u> |
| | | |
| Net assets: | | |
| Invested in capital assets, net related debt | \$ 72,902,412 | \$ 60,940,605 |
| Restricted | 163,319,890 | 102,456,804 |
| Unrestricted | <u>9,670,655</u> | <u>25,270,555</u> |
| Total Net assets | <u>\$245,892,957</u> | <u>\$188,667,964</u> |

Municipality's net assets, \$245.9 millions, reflects its investment in capital assets such land, buildings, equipment and infrastructure (roads, improvements and other immovable assets), less any related debt used to acquire those assets that still outstanding. The assets used to provide services to residents; consequentially, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The largest portion of the Municipality's restricted net assets, \$163.3 millions, represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets, \$9.7 millions, may be used to meet the Municipality's ongoing obligations to residents and creditors. Internally imposed designations of resources are not presented as restricted net assets.

The principal increase of the net assets were due mainly to the inclusion of real property acquisition donated from State Recreational and Sports Department of \$38.7 millions, for recreational parks and an increase in general infrastructure assets of \$22 millions, approximately.

The following reflects the comparative condensed Statement of Activities:

**Comparative Statement of Activities
For the Years Ended June 30, 2003 and 2002**

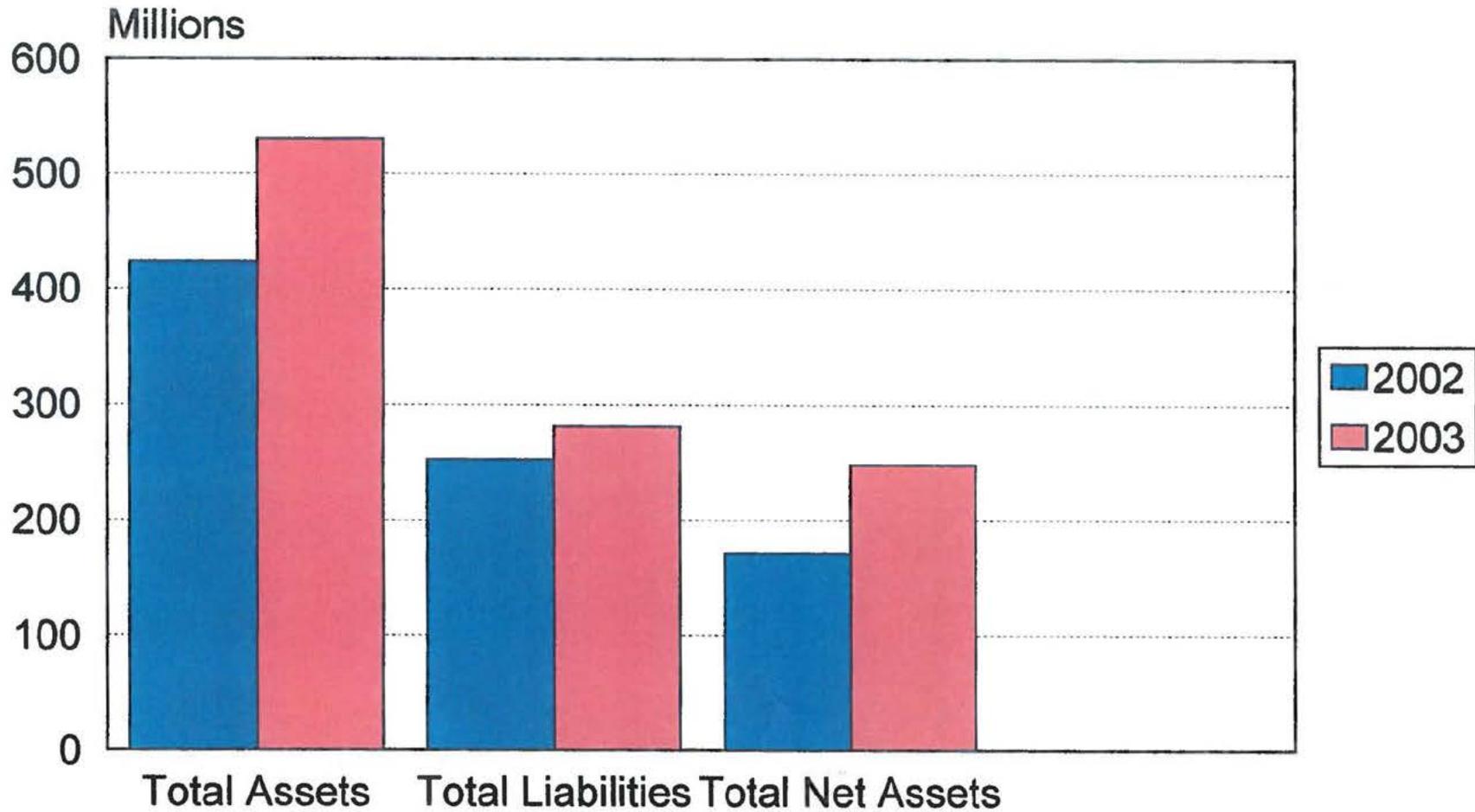
| | <u>June 30, 2003</u> | <u>June 30, 2002</u> |
|--------------------------------|----------------------|----------------------|
| General Revenues | \$118,446,600 | \$122,081,985 |
| Program Revenues | 69,743,845 | 26,911,067 |
| Enterprise | <u>2,495,410</u> | <u>4,263,003</u> |
| Total Revenues | <u>\$190,685,855</u> | <u>\$153,256,055</u> |
| Expenses | | |
| Governmental Activities | \$140,660,924 | \$129,900,369 |
| Enterprise | <u>57,832</u> | <u>1,379,949</u> |
| Total Expenses | <u>\$140,718,756</u> | <u>\$131,280,318</u> |
| Change in Net Assets | <u>\$ 49,967,099</u> | <u>\$ 21,975,737</u> |

The Municipality's changes in net assets increased by \$50 millions. The Municipality's program revenues increased by approximately \$42.8 (70%) millions, as compared with last fiscal year. Additional changes include:

- Total governmental activities revenues and expenses increased by \$39.8 (21%) and \$10.8 (8%) millions, respectively, as compared with prior fiscal year.
- Total operating grants and contribution increased in 2003 by \$9.1 (44%) millions, as compared with prior year.
- The general revenues decreased in 2003 by \$3.6 (2%) millions, as compared with last year. The principal decrease was in the property tax revenues.
- There was also a decrease in the enterprise fund revenues by \$1.8 (41%) millions, as compared with prior fiscal year. The primarily reason was the reacquirement of the Jesus T. Pineiro building.
- The increase in the governmental activities revenues and expenses were mainly to a real property donated contribution form State Recreational and Sport department as mentioned earlier and on economic development and employment opportunity expenses.
- The depreciation expense increased by \$382,200 (11%) in comparison with prior year.

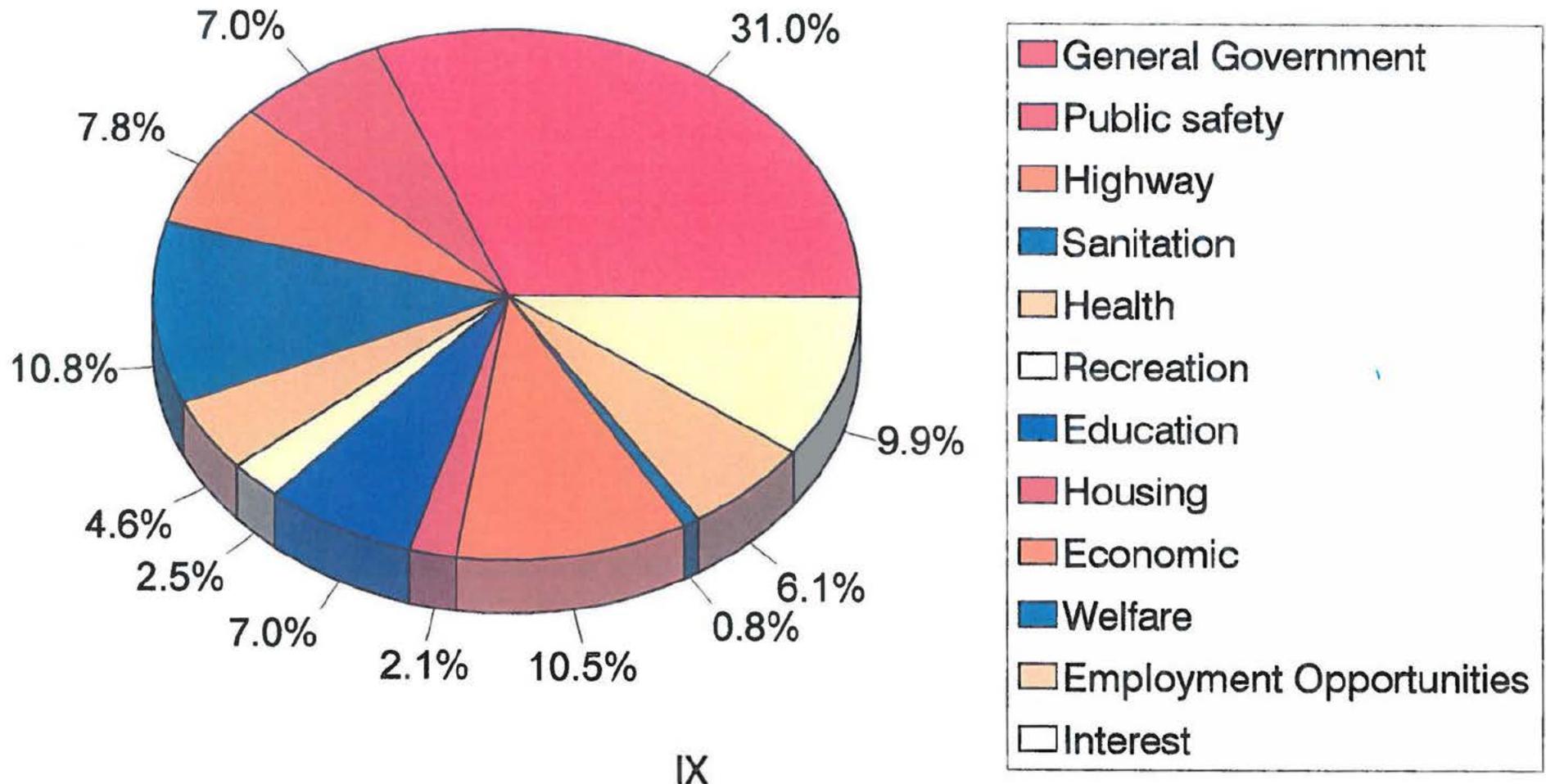
Municipality of Carolina

Comparative Condensed
Statement of Net Assets
For the Year Ended June 30, 2003



Municipality of Carolina

Statement of Activities
Expenses by Functions
For the Year Ended June 30, 2003

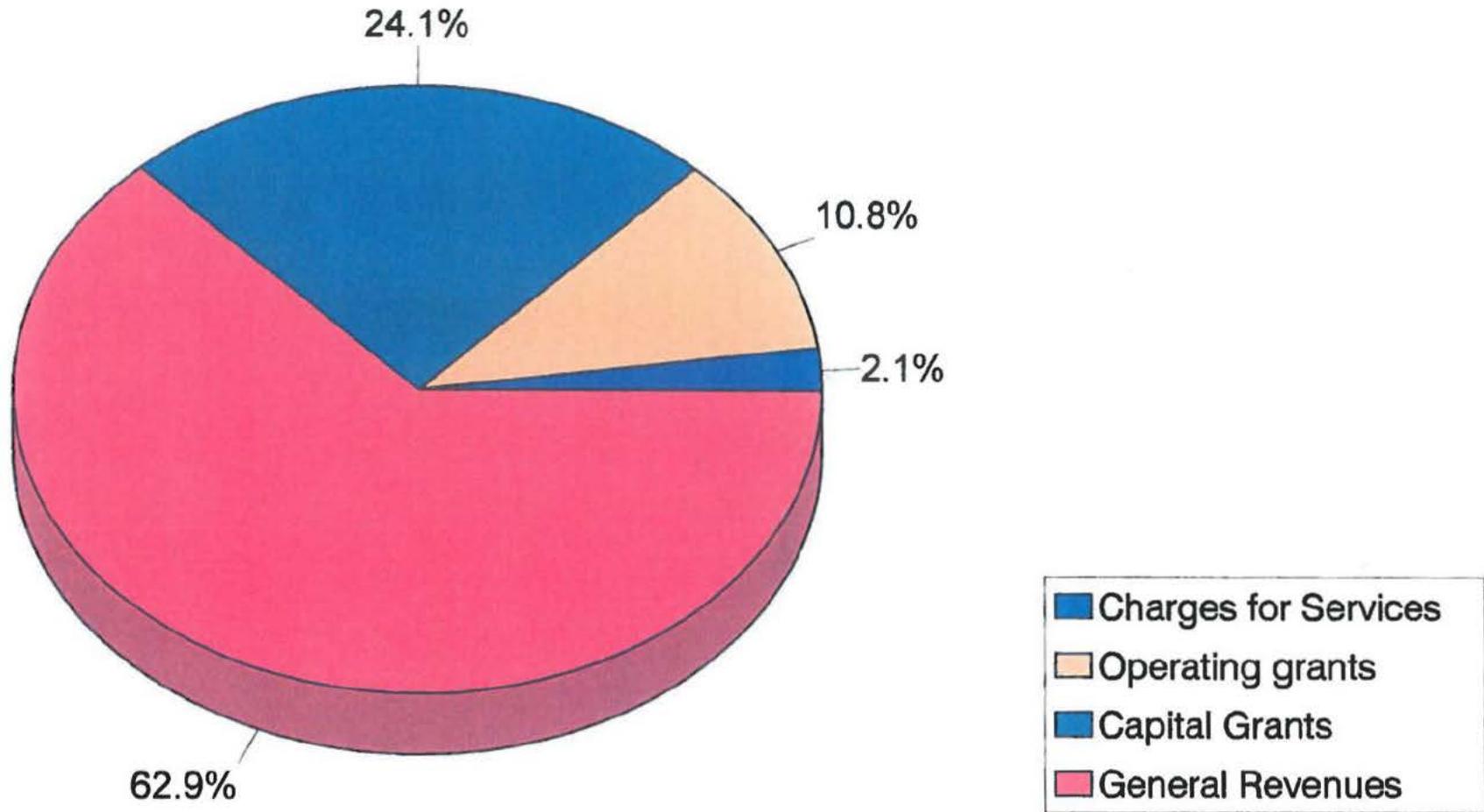


Municipality of Carolina

Statement of Activities

Income

For the Year Ended June 30, 2003



Governmental Funds

At the end of the current fiscal year, Municipality's governmental funds reported a combined fund balance of \$171.6 millions that is over last year for \$32.5 millions. The primary reason for the government fund's increase in the current year were proceeds from new debts recorded as other financial sources in the capital projects fund and legislative funds assignments recorded in the General fund. The General Fund and capital project fund experienced an increase of \$10.8 and \$18.7 millions, as compared with prior year fund balance. The following reflects the condensed comparative Combined Balance Sheet and Statements of Revenues, Expenditures and Changes in Fund Balances:

Comparative Combined Balance Sheet For the Years Ended June 30, 2003 and 2002

| | <u>June 30, 2003</u> | <u>June 30, 2002</u> |
|--------------------------------------|-----------------------------|-----------------------------|
| Cash | \$208,412,354 | \$179,633,741 |
| Receivables | <u>37,222,557</u> | <u>43,321,245</u> |
| Total Assets | <u>\$245,634,911</u> | <u>\$222,954,986</u> |
| Accounts payables | \$ 47,343,811 | \$ 52,074,105 |
| Deferred revenues | <u>26,661,787</u> | <u>31,451,216</u> |
| Total liabilities and credits | <u>\$ 74,005,598</u> | <u>\$ 83,525,321</u> |
| Fund Balances: | | |
| Reserved | \$160,240,060 | \$139,429,665 |
| Unreserved | <u>11,388,893</u> | <u>15,057,754</u> |
| Total fund balances | <u>\$171,628,953</u> | <u>\$139,429,665</u> |

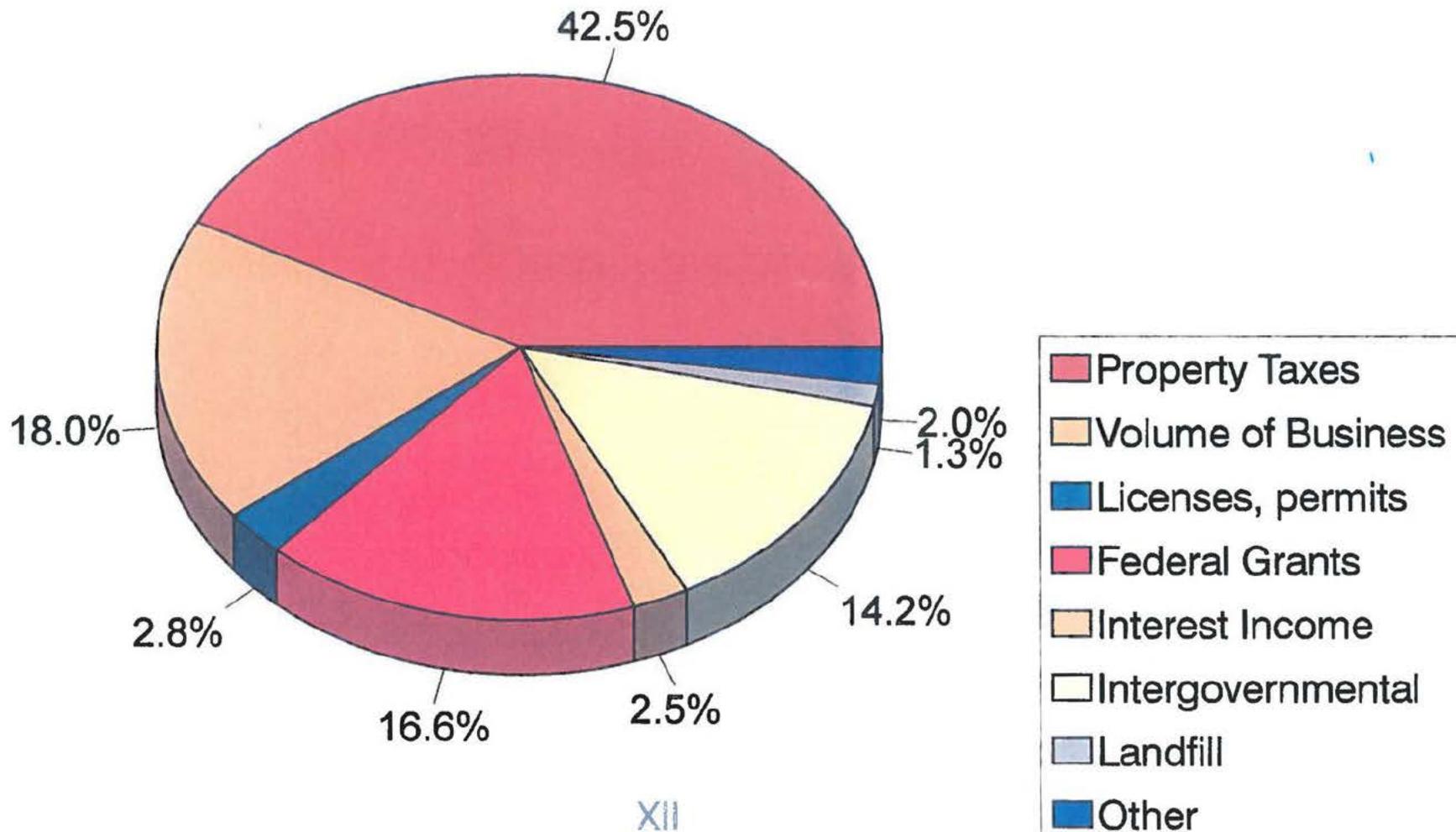
Comparative Combined Statement of Revenues, Expenditures and Change in Fund Balances For the Years Ended June 30, 2003 and 2002

| | <u>June 30, 2003</u> | <u>June 30, 2002</u> |
|--------------------------------|-----------------------------|-----------------------------|
| Revenues | \$150,097,631 | \$141,904,085 |
| Other financing sources | <u>99,233,012</u> | <u>22,404,271</u> |
| Total credits | <u>\$249,330,643</u> | <u>\$164,308,356</u> |
| Expenditures | \$168,189,155 | \$155,100,812 |
| Other financing uses | <u>41,133,813</u> | <u>20,341,451</u> |
| Total debits | <u>\$209,322,968</u> | <u>\$175,442,263</u> |
| Excess of credits over debits | \$ 40,077,675 | \$ (11,133,907) |
| Fund balance – Beg. (Restated) | <u>131,621,278</u> | <u>150,563,572</u> |
| Fund balance – End. | <u>\$171,628,953</u> | <u>\$139,429,665</u> |

Municipality of Carolina

Governmental Fund

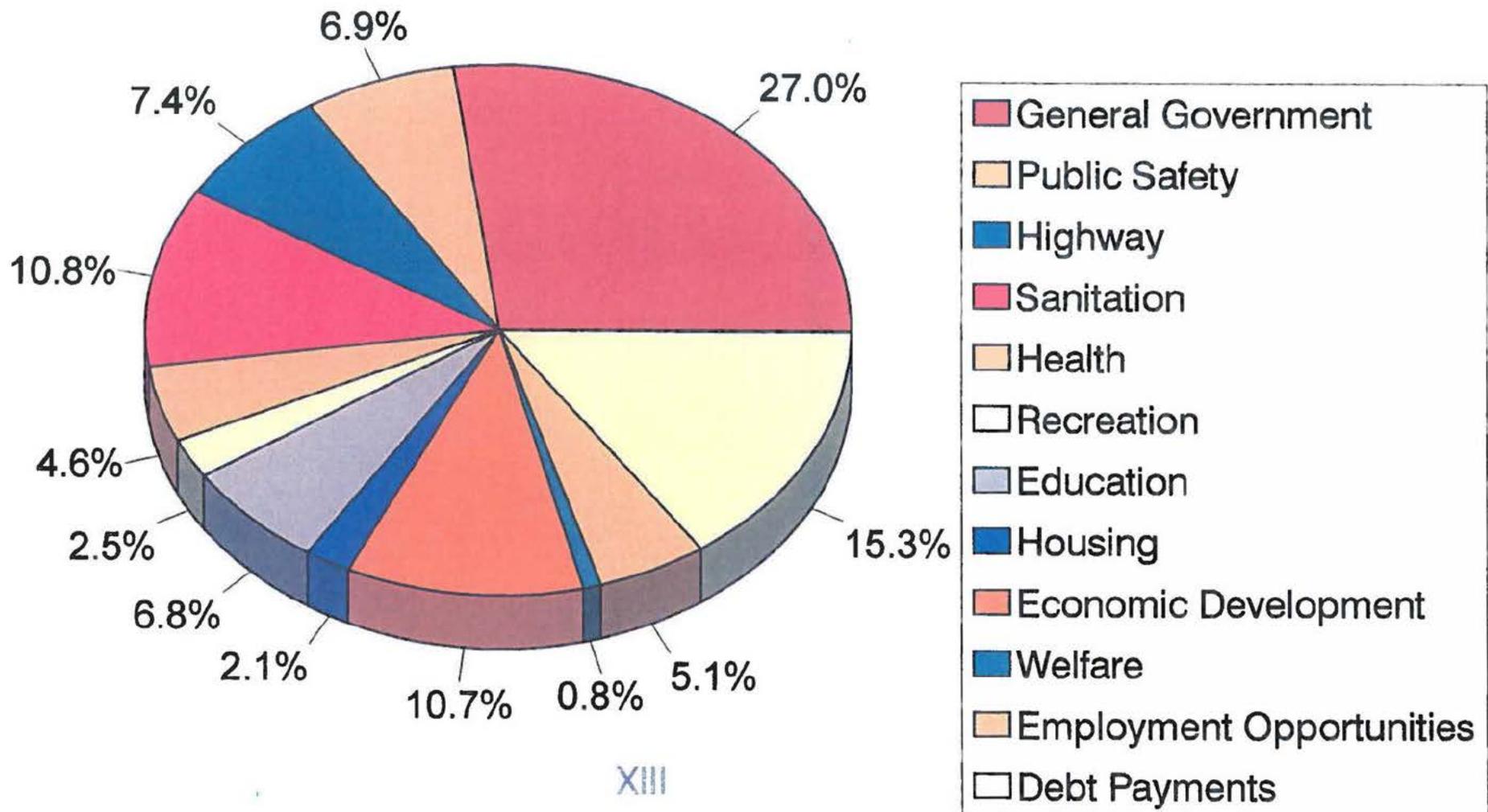
Combined Statement of Revenues
For the Year Ended June 30, 2003



Municipality of Carolina

Governmental Fund

Combined Statement of Expenditures
For the Year Ended June 30, 2003



Economic Factors and Next Year Budget

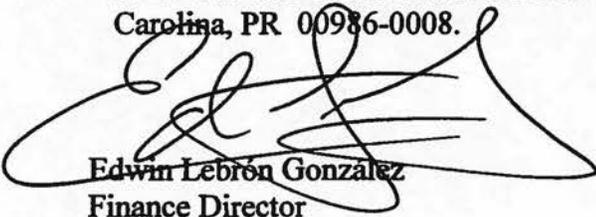
The Municipality is a political legal entity with full legislative and administrative powers in every area of municipal government, with perpetual existence and legal personality, separate and independent from the central governmental of Puerto Rico. The Municipal Government comprises the executive and legislative branches. The Mayor exercises the executive power and the legislative power by the Municipal Legislature, which has 16 members.

The Municipality provides a full range of services including public works, education, Public safety, public housing, health, community development, culture, recreation and other administrative services. The Municipality's principal sources of revenue are property taxes, municipal license taxes, contributions by the state government and federal grants. The municipality has a wide industrial base which include the International Airport, hotels, large pharmaceuticals, wholesalers, retail stores, financial institutions, restaurants, among others. This industrial base has increased substantially during the most recent years.

The Municipality's Budget for fiscal year 2003-2004 was \$211.7 millions, that is \$5.2 millions over last fiscal year (2002-2003).

Contacting the municipality's Financial Management

The Municipality's financial statements are designed to provide a general overview of the Municipality's finances for all Carolina residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance Office at (787) 757-2626 ext. 490 or addressed to: Municipality of Carolina, Office of Mayor, P.O. Box 8, Carolina, PR 00986-0008.



Edwin Lebrón González
Finance Director

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Net Assets

| | Governmental Activities | Business-Type Activities | June 30 | |
|-----------------------------------|----------------------------|-----------------------------|-----------------------|-----------------------|
| | | | 2003 | 2002 |
| ASSETS | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 99,789,258 | \$ 137,709 | \$ 99,926,967 | \$ 83,124,913 |
| Cash with fiscal agent | 108,623,096 | - | 108,623,096 | 96,644,800 |
| Volume of business tax receivable | 217,561 | - | 217,561 | 242,908 |
| Due from other governments | 10,665,197 | - | 10,665,197 | 8,109,897 |
| Federal grant receivables | 6,262,772 | - | 6,262,772 | 5,613,779 |
| Interest receivable | 202,325 | - | 202,325 | 331,129 |
| Property taxes receivable | 2,703,196 | - | 2,703,196 | 5,312,544 |
| Other receivables | 3,187,991 | 3,395,166 | 6,583,157 | 684,835 |
| Direct financing lease | - | - | - | - |
| Other assets | 396 | - | 396 | - |
| Total current assets | 231,651,792 | 3,532,875 | 235,184,667 | \$ 200,064,805 |
| Noncurrent assets: | | | | |
| Capital assets, net | 273,470,415 | 14,197,254 | 287,667,669 | 235,250,326 |
| Direct financing lease | 120,952 | 6,786,658 | 6,907,610 | 7,225,501 |
| Total noncurrent assets | 273,591,367 | 20,983,912 | 294,575,279 | 242,475,827 |
| Total assets | \$ 505,243,159 | \$ 24,516,787 | \$ 529,759,946 | \$ 442,540,632 |

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Net Assets (continued)

| LIABILITIES | Governmental Activities | Business-Type Activities | June 30 | |
|---|----------------------------|-----------------------------|-----------------------|-----------------------|
| | | | 2003 | 2002 |
| Current liabilities: | | | | |
| Bonds and notes payable, current | 14,340,000 | - | 14,340,000 | 11,803,000 |
| Capital lease obligation, current | 22,023 | 519,389 | 541,412 | 438,843 |
| Accounts payable and accrued liabilities | 18,085,843 | 145,882 | 18,231,725 | 34,501,411 |
| Accrued legal claims | 1,642,057 | - | 1,642,057 | 254,376 |
| Accrued compensated absences, current | 2,858,692 | - | 2,858,692 | 5,044,675 |
| Interest payable | 4,025,363 | - | 4,025,363 | 4,247,856 |
| Due to other governments | 1,981,444 | - | 1,981,444 | 1,131,528 |
| Deferred volume of business taxes | 20,591,709 | - | 20,591,709 | 21,095,540 |
| Other deferred | 5,342,571 | - | 5,342,571 | 3,739,636 |
| Due to federal agency | 473,402 | - | 473,402 | 291,807 |
| Total current liabilities | 69,363,104 | 665,271 | 70,028,375 | 82,548,672 |
| Noncurrent liabilities: | | | | |
| Bonds and notes payable, noncurrent | 192,265,930 | - | 192,265,930 | 151,476,130 |
| Capital lease obligation, non-current | 96,160 | 6,267,269 | 6,363,429 | 6,786,658 |
| Other long-term debt | - | 5,072,987 | 5,072,987 | - |
| Landfill obligations | 4,607,300 | - | 4,607,300 | 6,107,300 |
| Due to other governments | 4,056,309 | - | 4,056,309 | 4,381,449 |
| Accrued compensated absences | 1,472,659 | - | 1,472,659 | 2,572,459 |
| Total noncurrent liabilities | 202,498,358 | 11,340,256 | 213,838,614 | 171,323,996 |
| Total liabilities | 271,861,462 | 12,005,527 | 283,866,989 | 253,872,668 |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | 67,514,615 | 5,387,797 | 72,902,412 | 60,940,605 |
| Restricted for: | | | | |
| Capital projects | 79,055,364 | - | 79,055,364 | 48,057,567 |
| Economic development projects | 15,523,458 | - | 15,523,458 | 14,026,302 |
| Other purposes | 38,717,042 | - | 38,717,042 | 3,993,830 |
| Debt service | 26,944,196 | - | 26,944,196 | 32,370,125 |
| Employment programs | 3,079,830 | - | 3,079,830 | 4,008,980 |
| Unrestricted | 2,547,192 | 7,123,463 | 9,670,655 | 25,270,555 |
| Total net assets | 233,381,697 | 12,511,260 | 245,892,957 | 188,667,964 |
| Total liabilities and net assets | \$ 505,243,159 | \$ 24,516,787 | \$ 529,759,946 | \$ 442,540,632 |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Net Assets (continued)

| | June 30 | |
|---|-----------------------|-----------------------|
| | 2003 | 2002 |
| Fund balance per Fund Statements | \$ 171,628,953 | \$ 139,429,665 |
| Amounts reported for governmental activities in the statement of net assets are different because: | | |
| Capital assets used in governmental activities are not financial resources and not reported in the funds. | \$ 273,591,367 | \$ 225,465,769 |
| Other long term liabilities, such as accrued compensated absences, litigations and other contingencies are not available to pay for current year expenditures and therefore not reported in the funds | (14,755,200) | (18,328,115) |
| Resources not available to pay current year expenditures, but collectible after the period of availability, are not reported in the funds. | 727,507 | 6,616,040 |
| General obligation bonds, special and federal loans are not due and payable in the current period and therefore not reported in the funds. | <u>(197,810,930)</u> | <u>(163,279,130)</u> |
| Net assets of governmental activities | <u>\$ 233,381,697</u> | <u>\$ 189,904,229</u> |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Activities

Functions and Programs

| | <u>Expenses</u> | <u>Charges for services</u> | <u>Operating grants and contributions</u> | <u>Capital grants and contributions</u> | <u>Governmental activities</u> | <u>Business-type activities</u> | <u>Year Ended June 30</u> | |
|--------------------------------------|--------------------|-----------------------------|---|---|--------------------------------|---------------------------------|---------------------------|----------------------|
| | | | | | | | <u>Total 2003</u> | <u>Total 2002</u> |
| Governmental activities: | | | | | | | | |
| General government | \$ 43,719,468 | \$ 1,152,865 | \$ - | \$ - | \$ (42,566,603) | \$ - | \$ (42,566,603) | \$ (40,378,523) |
| Public safety | 9,896,108 | 86,321 | - | - | (9,809,787) | - | (9,809,787) | (12,984,655) |
| Highway, streets and transportation | 11,144,111 | - | - | - | (11,144,111) | - | (11,144,111) | (6,131,821) |
| Sanitation | 15,338,749 | 2,691,376 | - | - | (12,647,373) | - | (12,647,373) | (15,692,672) |
| Health | 6,540,035 | - | - | - | (6,540,035) | - | (6,540,035) | (7,981,267) |
| Recreation and sports | 3,579,256 | - | - | 38,658,164 | 35,078,908 | - | 35,078,908 | (6,097,315) |
| Education and training | 9,512,136 | - | 5,859,430 | - | (3,652,706) | - | (3,652,706) | (4,065,260) |
| Housing | 3,078,074 | - | 4,822,944 | - | 1,744,870 | - | 1,744,870 | (635,427) |
| Economic development | 13,980,121 | 80,201 | - | 6,626,313 | (7,273,607) | - | (7,273,607) | (414,745) |
| Welfare | 1,126,609 | 27,454 | 1,036,286 | - | (62,870) | - | (62,870) | (359,975) |
| Employment opportunities | 8,592,154 | - | 8,694,747 | - | 102,593 | - | 102,593 | 483,071 |
| Interest | 14,154,103 | - | - | - | (14,154,103) | - | (14,154,103) | (9,293,640) |
| Total governmental activities | 140,660,924 | 4,038,217 | 20,413,407 | 45,284,477 | (70,924,824) | - | (70,924,824) | (103,552,229) |
| Business-type activities | 57,832 | 7,744 | - | - | - | (50,088) | (50,088) | (817,022) |

General revenues:

| | | | | |
|---|--------------------|------------------|--------------------|--------------------|
| Property taxes | 63,808,138 | - | 63,808,138 | 73,999,901 |
| Volume of business taxes | 27,054,184 | - | 27,054,184 | 28,214,503 |
| License, and permits | 4,096,175 | - | 4,096,175 | 5,488,924 |
| Interest income | 3,793,519 | 1,194,809 | 4,988,328 | 5,902,798 |
| Intergovernmental | 19,242,625 | - | 19,242,625 | 7,119,816 |
| Other | 1,752,560 | - | 1,752,560 | 5,619,046 |
| Operating transfers | (1,300,601) | 1,300,601 | - | - |
| Total general revenues | 118,446,600 | 2,495,410 | 120,942,010 | 126,344,988 |
| Change in net assets | 47,521,777 | 2,445,322 | 49,967,099 | 21,975,737 |
| Net assets - beginning (as previously reported) | 161,156,724 | 10,065,938 | 171,222,662 | 171,222,661 |
| Prior period adjustments | 24,703,196 | - | 24,703,196 | (4,530,434) |
| Net assets - beginning (as restated) | 185,859,920 | 10,065,938 | 195,925,858 | 166,692,227 |
| Net assets - ending | \$ 233,381,697 | \$ 12,511,260 | \$ 245,892,957 | \$ 188,667,964 |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Governmental Fund Financial Statements
Combined Balance Sheet

| | General | Debt Service | Capital Projects | Economic Development | Employment Opportunity Municipal Agency | Other Governmental Funds | June 30 | |
|-------------------------------------|----------------------|----------------------|----------------------|-------------------------|---|--------------------------------|-----------------------|-----------------------|
| | | | | | | | Total 2003 | Total 2002 |
| Assets | | | | | | | | |
| Cash and certificates of deposits | \$ 67,940,893 | \$ 777,508 | \$ 11,209,915 | \$ 15,416,506 | \$ 13,920 | \$ 4,430,516 | \$ 99,789,258 | \$ 82,988,941 |
| Cash with fiscal agent | 638,713 | 38,693,485 | 69,290,898 | - | - | - | 108,623,096 | 96,644,800 |
| Volume of business taxes receivable | 217,561 | - | - | - | - | - | 217,561 | 242,908 |
| Due from other governments | 4,757,491 | - | 5,020,285 | - | - | 887,421 | 10,665,197 | 8,109,897 |
| Federal grants receivables | - | - | - | 489,621 | 2,032,276 | 3,740,875 | 6,262,772 | 5,613,779 |
| Due from other funds | 10,211,834 | 1,000 | 2,051,155 | 120,625 | 1,018,675 | 579,830 | 13,983,119 | 16,996,040 |
| Interest receivable | 133,411 | 30,703 | 38,211 | - | - | - | 202,325 | 331,129 |
| Property taxes receivable | - | 2,703,196 | - | - | - | - | 2,703,196 | 5,312,544 |
| Other receivables | 303,537 | - | 20,506 | 2,024,227 | 14,959 | 824,762 | 3,187,991 | 6,714,948 |
| Other assets | - | - | - | - | - | 396 | 396 | - |
| Total assets | \$ 84,203,440 | \$ 42,205,892 | \$ 87,630,970 | \$ 18,050,979 | \$ 3,079,830 | \$ 10,463,800 | \$ 245,634,911 | \$ 222,954,986 |

MUNICIPALITY OF CAROLINA, PUERTO RICO

Governmental Fund Financial Statements
Combined Balance Sheet (continued)

| | General | Debt Service | Capital Projects | Economic Development | Employment Opportunity Municipal Agency | Other Governmental Funds | June 30 | |
|--|----------------------|----------------------|----------------------|-------------------------|---|--------------------------------|-----------------------|-----------------------|
| | | | | | | | Total 2003 | Total 2002 |
| Liabilities and other credits | | | | | | | | |
| Accounts payable and accrued liabilities | \$ 10,332,233 | \$ - | \$ 1,975,306 | \$ 1,467,653 | \$ 1,949,050 | \$ 2,361,601 | \$ 18,085,843 | \$ 21,888,442 |
| Bonds and notes payable | - | 8,795,000 | - | - | - | - | 8,795,000 | 8,005,000 |
| Interest payable | - | 4,023,290 | - | - | - | 2,073 | 4,025,363 | 3,761,288 |
| Due to other governments | 1,981,444 | - | - | - | - | - | 1,981,444 | 1,036,951 |
| Due to other funds | 1,969,842 | 143,406 | 6,175,531 | 1,059,868 | 1,018,675 | 3,615,797 | 13,983,119 | 16,996,040 |
| Deferred volume of business taxes | 20,591,709 | - | - | - | - | - | 20,591,709 | 21,095,540 |
| Due to Federal Agency | - | - | - | - | 112,105 | 361,297 | 473,402 | 386,384 |
| Other deferred revenue | 2,213,360 | 2,300,000 | 424,769 | - | - | 1,131,949 | 6,070,078 | 10,355,676 |
| Total liabilities and other credits | 37,088,588 | 15,261,696 | 8,575,606 | 2,527,521 | 3,079,830 | 7,472,717 | 74,005,958 | 83,525,321 |
| Fund Equity | | | | | | | | |
| Fund balances | | | | | | | | |
| Reserved for encumbrances | 12,595,330 | - | - | - | - | 2,991,083 | 15,586,413 | 3,104,523 |
| Reserved for other purposes | 22,619,958 | - | - | - | - | - | 22,619,958 | 18,233,849 |
| Reserved for equipment | 510,671 | - | - | - | - | - | 510,671 | 520,113 |
| Reserved for capital projects | - | - | 79,055,364 | - | - | - | 79,055,364 | 59,236,680 |
| Reserved for grants and economic Development projects | - | - | - | 15,523,458 | - | - | 15,523,458 | 15,954,421 |
| Reserved for debt service | - | 26,944,196 | - | - | - | - | 26,944,196 | 27,322,325 |
| Unreserved | 11,388,893 | - | - | - | - | - | 11,388,893 | 15,057,754 |
| Total fund balances | 47,114,852 | 26,944,196 | 79,055,364 | 15,523,458 | - | 2,991,083 | 171,628,953 | 139,429,665 |
| Total liabilities and fund balances | \$ 84,203,440 | \$ 42,205,892 | \$ 87,630,970 | \$ 18,050,979 | \$ 3,079,830 | \$ 10,463,800 | \$ 245,634,911 | \$ 222,954,986 |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Governmental Fund Financial Statements
Combined Statement of Revenues, Expenditures and Changes in Fund Balances-

| | General | Debt Service | Capital Projects | Economic Development | Employment Opportunity Municipal Agency | Other Governmental Funds | Year Ended June 30 | |
|---|----------------------|----------------------|----------------------|----------------------|---|--------------------------|-----------------------|-----------------------|
| | | | | | | | Total 2003 | Total 2002 |
| Revenues : | | | | | | | | |
| Property taxes | \$ 48,454,868 | \$ 15,353,270 | \$ - | \$ - | \$ - | \$ - | \$ 63,808,138 | \$ 67,873,743 |
| Volume of business taxes | 27,054,184 | - | - | - | - | - | 27,054,184 | 28,214,503 |
| Licenses, permits, fines and forfeits | 4,179,496 | - | - | - | - | 3,000 | 4,182,496 | 5,488,924 |
| Federal grants | - | - | 25,260 | 6,601,053 | 8,694,747 | 9,645,888 | 24,966,948 | 23,176,042 |
| Interest income | 3,509,458 | - | 4,614 | 272,736 | - | 6,510 | 3,793,318 | 4,571,348 |
| Intergovernmental | 19,242,625 | - | - | - | - | 2,072,973 | 21,315,598 | 8,712,097 |
| Landfill | 1,963,869 | - | - | - | - | - | 1,963,869 | 532,509 |
| Rent | 1,152,865 | - | - | - | - | - | 1,152,865 | 588,062 |
| Other | 1,752,560 | - | 80,201 | - | - | 27,454 | 1,860,215 | 2,746,857 |
| Total revenues | 107,309,925 | 15,353,270 | 110,075 | 6,873,789 | 8,694,747 | 11,755,825 | 150,097,631 | \$ 141,904,085 |
| Expenditures | | | | | | | | |
| General government | 45,560,714 | - | - | - | - | 520 | 45,561,234 | 38,952,200 |
| Public safety | 11,672,157 | - | - | - | - | 125,932 | 11,798,089 | 11,652,157 |
| Highway, streets and transportation | 12,624,412 | - | - | - | - | 18,611 | 12,643,023 | 5,615,965 |
| Sanitation | 18,315,259 | - | - | - | - | - | 18,315,259 | 15,970,806 |
| Health | 7,856,439 | - | - | - | - | - | 7,856,439 | 7,884,505 |
| Recreation and sports | 4,170,818 | - | - | - | - | 145 | 4,170,963 | 5,437,882 |
| Education and training | 4,322,849 | - | - | - | - | 6,638,971 | 10,961,820 | 10,293,093 |
| Housing | 2,137,288 | - | - | - | - | 1,469,742 | 3,607,030 | 5,896,633 |
| Economic development | - | - | 12,433,977 | 4,759,278 | - | - | 17,193,255 | 24,623,284 |
| Welfare | - | - | - | - | - | 1,360,193 | 1,360,193 | 520,301 |
| Employment opportunity | - | - | - | - | 8,694,747 | - | 8,694,747 | 8,416,914 |
| Debt service payments | - | 21,736,686 | 4,290,417 | - | - | - | 26,027,103 | 19,837,072 |
| Total expenditures | 106,659,936 | 21,736,686 | 16,724,394 | 4,759,278 | - | 9,614,114 | 168,189,155 | 155,100,812 |
| Other financing sources (uses) | | | | | | | | |
| Proceeds from debt issuance | - | - | 59,399,800 | - | - | - | 59,399,800 | 2,062,820 |
| Operating transfer in | 23,323,748 | 6,005,287 | 9,274,052 | 930,125 | - | 300,000 | 39,833,212 | 20,341,451 |
| Operating transfer out | (13,033,865) | - | (24,624,349) | (3,475,599) | - | - | (41,133,813) | (20,341,451) |
| Other financing sources (uses) | 10,289,883 | 6,005,287 | 44,049,503 | (2,545,474) | - | 300,000 | 58,099,199 | 2,062,820 |
| Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses | 10,939,872 | (378,129) | 27,435,184 | (430,963) | - | 2,441,711 | 40,007,675 | (11,133,907) |
| Fund balances at beginning of year (as previously reported) | 36,378,867 | 27,322,325 | 59,236,680 | 15,954,421 | - | 537,372 | 139,429,665 | 151,279,926 |
| Prior period adjustment | (203,887) | - | (7,616,500) | - | - | 12,000 | (7,808,387) | (716,354) |
| Fund balances at beginning of year (as restated) | 36,174,980 | 27,322,325 | 51,620,180 | 15,954,421 | - | 549,372 | 131,621,278 | 150,563,572 |
| Fund balances at end of year | \$ 47,114,852 | \$ 26,944,196 | \$ 79,055,364 | \$ 15,523,458 | \$ - | \$ 2,991,083 | \$ 171,628,953 | \$ 139,429,665 |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances of Governmental Funds
to the Statement of Activities

| | Year Ended June 30 | |
|--|-----------------------|----------------------|
| | <u>2003</u> | <u>2002</u> |
| Net change in fund balance - total governmental funds | \$ 40,007,675 | \$ (11,133,907) |
| Amounts reported in the statement of activities are different because: | | |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period. | 21,043,767 | 19,053,769 |
| Capital assets donated during the year are not current financial resources and therefore are not reported in the funds | 38,658,164 | - |
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. | 727,507 | 6,616,040 |
| General long term debt proceeds provide current financial resources to governmental funds, but issuing debt increases long term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets. This is the amount by which proceeds exceed or are below the repayments | (47,526,800) | 8,967,180 |
| Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. | <u>(5,388,536)</u> | <u>(5,366,397)</u> |
| Change in net assets of governmental activities | <u>\$ 47,521,777</u> | <u>\$ 18,136,685</u> |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Revenues and Expenditures
 Budget and Actual- General Fund
 Non GAAP Budgetary Basis
 Year Ended June 30, 2003

| | <u>Original Budget</u> | <u>Final Budget</u> | <u>Actual amounts in the budgetary basis</u> | <u>Variance Favorable (Unfavorable)</u> |
|--|------------------------|-----------------------|--|---|
| Resources: | | | | |
| Property taxes | \$ 46,130,970 | \$ 46,968,311 | \$ 48,454,868 | \$ 1,486,557 |
| Volume of business taxes | 23,763,465 | 25,676,586 | 26,865,022 | 1,188,436 |
| Licenses and permits | 337,000 | 1,274,558 | 2,562,567 | 1,288,009 |
| Fines and penalties | 500,000 | 500,000 | 86,321 | (413,679) |
| Interest income | 1,500,000 | 2,024,696 | 3,509,458 | 1,484,762 |
| Intergovernmental | 6,414,460 | 6,417,794 | 6,513,736 | 95,942 |
| Landfill | - | - | 50,714 | 50,714 |
| Rent | 84,000 | 169,000 | 172,123 | 3,123 |
| Other | 128,123 | 876,367 | 1,607,229 | 730,862 |
| Readjustments of prior years | - | 13,565,126 | - | (13,565,126) |
| Transfer-in | - | 20,534,639 | 20,534,639 | - |
| Amounts available for appropriation | <u>\$ 78,858,018</u> | <u>\$ 118,007,077</u> | <u>\$ 110,356,677</u> | <u>\$ (7,650,400)</u> |
| Expenditures charged to appropriations: | | | | |
| General government | 41,552,930 | 57,845,060 | 51,240,349 | 6,604,711 |
| Public safety | 11,730,229 | 11,955,970 | 11,783,254 | 172,716 |
| Highways, streets and transportation | 4,981,664 | 6,092,055 | 6,070,651 | 21,404 |
| Sanitation | 5,337,255 | 23,651,419 | 23,562,599 | 88,820 |
| Health | 7,853,847 | 7,853,847 | 7,853,847 | - |
| Recreation and sports | 3,496,075 | 4,427,237 | 4,308,146 | 119,091 |
| Education | 3,538,544 | 4,877,888 | 4,426,393 | 451,495 |
| Housing and building | 367,474 | 1,303,601 | 418,032 | 885,569 |
| Total charges to appropriations | <u>78,858,018</u> | <u>118,007,077</u> | <u>109,663,271</u> | <u>8,343,806</u> |
| Excess of resources over appropriations | | | <u>\$ 693,406</u> | <u>\$ 693,406</u> |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Net Assets
Proprietary Fund

| | June 30 | |
|--|----------------------|----------------------|
| | <u>2003</u> | <u>2002</u> |
| Current Assets: | | |
| Cash and cash equivalents | \$ 137,709 | \$ 35 |
| Investments | - | 135,937 |
| Receivables (net) | <u>3,395,166</u> | <u>1,763,250</u> |
| Total current assets | <u>3,532,875</u> | <u>1,899,222</u> |
| Noncurrent Assets: | | |
| Capital assets: | | |
| Buildings and equipment, net | 2,844,000 | 2,844,000 |
| Capital assets (net) | <u>11,353,254</u> | <u>11,403,342</u> |
| Assets under capital lease (net of unearned interest of \$4,983,886 in 2003 and \$6,176,959 in 2002) | 14,197,254 | 14,247,342 |
| | <u>6,786,658</u> | <u>7,225,501</u> |
| Total non-current assets | <u>20,983,912</u> | <u>21,472,843</u> |
| Total assets | <u>\$ 24,516,787</u> | <u>\$ 23,372,065</u> |

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Net Assets (continued)
Proprietary Funds

| | June 30 | |
|--|----------------------|----------------------|
| | <u>2003</u> | <u>2002</u> |
| <u>Liabilities</u> | | |
| Current Liabilities: | | |
| Capital lease obligation, current | \$ 519,389 | \$ 438,843 |
| Accounts payable | <u>145,882</u> | <u>145,882</u> |
| Total current liabilities | <u>665,271</u> | <u>584,725</u> |
| Non-current liabilities: | | |
| Capital lease obligation, non-current | 6,267,269 | 6,786,658 |
| Revenue bonds payable | <u>5,072,987</u> | <u>5,934,745</u> |
| Total non-current liabilities | <u>11,340,256</u> | <u>12,721,403</u> |
| Total liabilities | <u>12,005,527</u> | <u>13,306,128</u> |
| <u>Net assets</u> | | |
| Invested in capital assets (net of related debt) | 5,387,797 | 4,087,196 |
| Unrestricted | <u>7,123,463</u> | <u>5,978,741</u> |
| Total net assets | <u>12,511,260</u> | <u>10,065,937</u> |
| Total liabilities and net assets | <u>\$ 24,516,787</u> | <u>\$ 23,372,065</u> |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of Revenues, Expenses and Changes in Net Assets
Proprietary Fund

| | Year Ended | |
|---|---------------|---------------|
| | June 30 | |
| | 2003 | 2002 |
| Operating revenues: | | |
| Charges for services | \$ 7,744 | \$ 5,278 |
| Operating Expenses: | | |
| General and administrative | 7,744 | 544,096 |
| Depreciation | 50,088 | 835,852 |
| Total operating expenses | 57,832 | 1,379,948 |
| Operating (loss) | | |
| Non-operating revenues | | |
| Interest on direct financing lease | 1,193,073 | 763,198 |
| Interest income | 1,736 | 9,150 |
| Total non-operating revenues (expenses) | 1,194,809 | 772,348 |
| Net income before operating transfer | 1,144,721 | (602,322) |
| Transfer from governmental fund | 1,300,601 | 4,048,304 |
| Change in net assets | 2,445,322 | 3,445,982 |
| Net assets at beginning of year | 10,065,938 | 6,619,956 |
| Net assets at end of year | \$ 12,511,260 | \$ 10,065,938 |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

Statement of cash flows - Proprietary Fund
Proprietary Funds

| | Year Ended June 30 | |
|---|-----------------------|--------------|
| | 2003 | 2002 |
| Cash flows from operating activities: | | |
| Receipts from operations | \$ 7,744 | \$ 5,278 |
| Payments in operations | (7,744) | (5,278) |
| Net cash provided by (used in) operating activities | - | - |
| Cash flows from capital and related financing activities: | | |
| Transfer from governmental fund | 1,300,601 | 4,048,304 |
| Principal paid on capital debt | (1,300,601) | (4,048,304) |
| Net cash provided by (used in) capital and related financing activities | - | - |
| Cash flows from investing activities: | | |
| Selling of investments | 137,673 | - |
| Interest income | 1,737 | - |
| Purchases of investments | (1,736) | - |
| Net cash provided by investing activities | 137,674 | - |
| Net increase in cash and cash equivalents | 137,674 | - |
| Cash at beginning of year | 35 | 35 |
| Cash at end of year | \$ 137,709 | \$ 35 |
| Reconciliation of operating (loss) to net cash provided by (used in) operating activities: | | |
| Adjustments to reconcile operating income (loss) to net cash provided in (used by) operating activities: | | |
| Operating (loss) | \$ (50,088) | (1,374,671) |
| Depreciation | 50,088 | 835,852 |
| Decrease in accounts payables | - | (3,899,222) |
| Decrease in accounts receivables | - | 4,438,041 |
| Net cash provided by (used in) operating activities | \$ - | \$ - |

The accompanying notes are an integral part of the basic financial statements

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003GENERAL ORGANIZATION

The Municipality of Carolina (the Municipality) was founded in 1857. The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of Puerto Rico. The legislative body consists of sixteen assemblymen also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public safety, sanitation, recreation and sports, education, housing, transportation, welfare, construction and/or improvements of highways and streets, and other general and administrative services.

The financial statements of the Municipality of Carolina (the Municipality) have been prepared in conformity with generally accepted accounting principles (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the primary standard-setting body for establishing governmental accounting and financial reporting principles. The following summarizes the Municipality significant accounting policies:

Note 1 - Summary of significant accounting policiesReporting Entity

The Municipality's financial statements include the operations of all departments and update legal entities for which the Municipality is financially accountable or for which exclusion would have the financial statements misleading or incomplete.

In June 1999, the GASB issued Statement No. 34 Basic Financial Statements and Management Discussion and Analysis for State and Local Governments. This Statement establishes new financial reporting requirements for state and local governments. It requires new information and restructures much of the information that governments have reported in the past. Comparability with reports issued in prior years is affected. In June 2001, the GASB issued Statement No. 37 Basic Financial Statements and Management Discussion and Analysis for State and Local Governments Omnibus, which in part addressed the Management Discussion and Analysis (MD&A) requirements, Program Revenue Classifications and Major Fund criteria requirements in the reporting model in Statement No. 34.

The Municipality of Carolina implemented this Standard for the fiscal year ended June 30, 2002.

MUNICIPALITY OF CAROLINA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Basic Financial Statements-GASB Statement No. 34

The basic financial statements include both government-wide and fund financial statements. While the previous model emphasized fund types (the total of all funds of a particular type), in the new reporting model the focus is on major individual funds (within the fund financial statements). Both the government-wide and fund financial statements categorize activities as governmental activities. In the government-wide Statement of Net Assets the governmental activities (a) are presented on a consolidated basis in one column, and (b) are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The government-wide Statement of Activities reflects both the gross and net cost per functional category. The Statement of Activities reduces gross expenses (including depreciation) by related operating grants and contributions. The operating grants include operating-specific grants.

This government-wide focus is more on the substantiality of the Municipality the change in aggregate economic position resulting from the activities of the fiscal period.

The fund financial statements are, in substance, very similar to the financial statements presented in the previous model. Emphasis here is on the major funds in the governmental category. Non-major funds are aggregated into a single column.

The governmental funds financial statements are presented on a current financial resource measurement focus and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. This presentation is deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality actual experience conforms to the budget or fiscal plan. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statement, a reconciliation is presented on the fund statement, which briefly explains the adjustments necessary to transform the fund statements into the governmental wide statements.

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003Basis of Presentation

The new model as defined in Statement No. 34 establishes criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of either fund category or the governmental and enterprise combined) for the determination of major funds. The Municipality reports the following major funds on Fund Financial Statements:

Government Funds

General Fund - Always a major fund. The general fund is the main operating fund of the Municipality. It is used to account for all financial resources except those required to be accounted for in other funds.

Economic Development Fund - Accounts for the proceeds of Federal Grants and loans and Local Special assignments to develop specific purpose on the Economy of the Municipality.

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

Capital Projects Fund - Capital projects fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements which are not financed by other funds.

Employment Opportunity Municipal Agency (Workforce Investment Area of Municipality of Carolina-Local Area)- An entity organized by the Municipality of Carolina as requested by the Governor of Puerto Rico, in accordance with Section 116 of the Workforce Investment Act (WIA) and Section 2.001 of the Autonomous Municipal Law of Puerto Rico. The entity was designated as Service Delivery Area (SDA) according to the provision of the Workforce Investment Act of 1998, set forth in Section 116 and the federal regulation as issued by the U.S. Secretary of Labor for the implementation of WIA. The purpose of the organization is to establish programs to provide remedial education, training and employment assistance to economically disadvantages youth and adults, and persons facing multiple barriers to employment and dislocated workers.

Business Type ActivitiesEnterprise Fund

The Enterprise fund is accounted for using the accrual basis of accounting. Its revenues are recognized when they are earned and their expenses are recognized when they are incurred. Most of the fund transactions are made through a financing institution.

MUNICIPALITY OF CAROLINA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Basis of Accounting

The accounts of the Municipality are organized on the basis of funds, each of which is considered to be a separate accounting entity. The Municipality has created various types of funds. Each fund is accounted for by a separate set of self-balancing accounts, which include its assets, liabilities, fund balances, and revenues and expenditures/expenses, as applicable. The individual funds accounts for the governmental resources allocated to the Municipality for the purpose of carrying on specific activities in accordance with laws, regulations, or other restrictions.

Measurement Focus

Government-wide Financial Statements. The government wide financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non exchange transactions, in which the Municipality gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants. Revenue from grants is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Funds Financial Statement. Governmental funds are those through which most governmental functions of the Municipality are financed. The acquisition, use, and balances of the Municipality's expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Available means collectible within the current period or 60 days after the end of the period to use them to pay liabilities of the current period. Miscellaneous revenues are recorded when collected. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the year to which they apply. Expenditures are generally recognized when the related fund liability is incurred. General capital asset acquisitions are reported as expenditures in governmental funds.

Licenses and permits, charges for services, fines and forfeits and miscellaneous revenues (except investment earnings) are recorded as revenues when received. Investment earnings (interest) are recorded as earned since they are measurable and available.

MUNICIPALITY OF CAROLINA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Encumbrances

Governmental funds employ encumbrances accounting. Under the encumbrance system, all purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation. Under generally accepted accounting principles, encumbrances outstanding at year-end are reported as balance and they constitute neither expenditures, nor liabilities. Encumbrances constitute the equivalent of expenditures for budgetary purposes only, and, accordingly, are reported with expenditures in all budgetary basis statements.

Budgetary Data

The Municipality follows these procedures, which are in accordance with the municipal law; in establishing the budgetary data reflected in the basic financial statements.

- (1) On or prior to May 15, the Mayor submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.
- (2) The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- (3) Prior to July 1st., the annual budget is legally enacted through passage of the annual appropriation ordinance.
- (4) Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget. Adjustments made during fiscal year June 30, 2003 amounted to \$13,565,126 are reflected in the budget information as adjustments of prior years included in the basic financial statements.

The budget is prepared following the modified accrual basis of accounting except for the encumbrances as described below.

The actual results of operations, presented in the Statement of Revenues, Expenditures and Changes in Fund Balances-Budget and Actual-General Fund, are reflected in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

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

Since the budgetary basis differs from generally accepted accounting principles (GAAP), actual amounts for the general fund and debt service fund in the accompanying Statement of Revenues and Expenditures-Budget and Actual are presented on the budgetary basis to enhance comparability. The principal differences are as follows:

- (1) Encumbrances are recorded as expenditures under the budgetary basis and as reservations of fund balance under the GAAP basis.
- (2) The property tax advances are presented as revenue in the budgetary basis and as other financing sources in the GAAP basis.
- (3) The Municipality receives certain revenues as contributions from governmental entities, legislative and private parties, which are not included therein nor are the related expenditures.
- (4) Certain debt issuance to acquire personal property is reflected in the general fund and is restricted for that purpose.

The necessary adjustments to convert the result of operations of the general and debt service funds from the modified accrual basis of accounting to the budgetary basis for fiscal year June 30, 2003 are as follows:

| | |
|--|---------------|
| Accounting per the Statement of Revenues, Expenditures and Changes in Fund Balance | \$ 10,939,872 |
| Adjustments: | |
| Non-budgeted funds received during the year | (20,276,995) |
| Non-budgeted funds expended during the year | 10,489,707 |
| Current year encumbrances recognized as expenditures on the budgetary basis | (2,746,570) |
| Prior year encumbrances recognized as expenditures on the accounting basis | 2,287,392 |
| | <hr/> |
| Excess of revenues (expenditures) over expenditures (revenues) budgetary basis | \$ 693,406 |

MUNICIPALITY OF CAROLINA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Deposits

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

Investments consist of short-term certificates of deposit and are stated at cost, which approximates fair value.

Inventories

The general fund purchases office and printing supplies, gasoline, oil, medicines and other items. The cost of purchases is recorded as an expenditure and the inventory is not recorded in the basic financial statements since amount is insignificant.

Capital Assets

Fund Financial Statement:

The capital assets acquired are recorded as expenditures at cost in the governmental funds.

Government Wide Financial Statement:

Purchased capital assets are recorded at cost. Donated capital assets are recorded at their estimated fair value at the time they are received by the Municipality and is capitalized in the Statement of Net Assets. Major renewals and betterment are capitalized: replacement, maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to operations.

MUNICIPALITY OF CAROLINA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Depreciation is provided over the estimated useful life of the respective assets on straight-line basis.

Vacation and Sick Leave and Other Compensated Absences

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years or more of service who are entitled to sick leave pay to the maximum allowed. The Municipality is required to pay excess sick leave over 90 days on or before March 31 of the accumulated excess at December 31 of prior year.

Employees' maximum allowed accumulated vacation, with the employer's share of payroll taxes, are accounted in the Statement of Net Asset.

Insurance

The Municipality has insurance coverage for its public facilities and equipment, primarily to provide protection in case of disaster and other losses. Also, principal officials of the Municipality are covered under various surety bonds. The Secretary of the Department of the Treasury of the Commonwealth of Puerto Rico is the designated agency to obtain the necessary insurance coverage for the Municipality.

Restricted Net Assets

Cash with fiscal agent:

The cash with fiscal agent pertaining to the debt service represents property tax collections retained by the Government Development Bank for Puerto Rico and another financial institution restricted for the payment of Municipality's debt service (See Note 2) and unused proceeds from bonds and notes issued principally for the acquisition or construction of permanent improvements are accounted in the capital project fund.

Reservations of Fund Balance:

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

- ★ Encumbrances - Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

MUNICIPALITY OF CAROLINA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

- ★ Debt Service - Represents net assets available to finance future debt service payments.
- ★ Capital Projects - Represent net assets available to finance future capital outlays.
- ★ For equipment and other purposes - Represents net assets legally segregated for acquisition of equipment and other specific future use.
- ★ For economic development projects - Represent net assets available to finance and subsidize other projects.

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 and in the Statement of Net Assets.

Use of Estimates

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

Note 2 - Property taxes

The "Centro de Recaudación de Ingresos Municipales" (CRIM) is responsible for the assessment of all real and personal property located within the Municipality of Carolina and for the levy, administration and collection of the corresponding taxes.

The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of the assessment.

Real property taxes are billed by the CRIM and are due in two equal installments in July and January following the assessment date. Personal property taxes are self-assessed and are due in May 15, when the property tax return is required to be filed.

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

The tax rate per annum is 8.33% for real property and 6.33% for personal property of which 3.8% and 1.83%, respectively, belongs to the Commonwealth of Puerto Rico and 4.5% of both percents belong to the Municipality. From the portion belonging to the Municipality, 3% represents the Municipality's basic tax rate, which is appropriated for general purposes and, therefore, accounted for through the general fund. The remaining portion belonging to the Municipality of 1.5% represents the "ad-valorem" tax withheld by the CRIM as fiscal agent, and restricted for debt service which is accounted for through the debt service fund (See Note 11). The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500, on which a complete exemption is granted. Veterans have additional exemption from taxes of \$5,000 of the assessed value of real property. The Department of Treasury instead of the property taxpayer becomes the source of payment in these cases.

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

The CRIM reports annually to the Municipality the estimated basic property tax and the tax to be used for the debt service, which will be collected in the fiscal year. The basic tax is advanced to the Municipality during such fiscal year. It is the practice to amortize these advances through the subsequent collection by the CRIM of the basic tax from the taxpayers.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, the Municipality recognized as an expenditure the operational expenses allocated by the CRIM to the Municipality, which amounted to \$1,766,632 and \$1,676,420 during fiscal years ended June 30, 2003 and 2002, respectively.

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

The following is a summary of the property tax advances, which resulted as an account payable, for the year ended June 30, 2003 and outstanding debt from June 30, 2000. The resulting receivable is presented as a deferred revenue in the general fund for Fund Financial Statement and as a revenue in the Government Wide Financial Statements. The debt has been presented in the Statement of Net Assets as a non-current liability since payment is not anticipated to be paid in near future.

Accounts Payable:

| | | |
|---|-------------------------|-------------------------|
| Amortization through collections of property taxes by the CRIM | \$ 46,527,504 | \$ 46,160,414 |
| Advanced received, 7/1/02 -6/30/03 | <u>47,474,475</u> | <u>(45,134,256)</u> |
| Due to CRIM | <u>\$ 946,971</u> | <u>\$ 1,026,158</u> |
| Due to CRIM-2000 | <u>\$ 4,056,309</u> | <u>\$ 4,381,449</u> |

The payment for the outstanding debt amounted \$4,056,309, which resulted from prior year advances, will be provided by a special loan approved by Municipal Assembly and to be issued by the Government Development Bank for Puerto Rico

Note 3 - Cash, cash equivalents, and investments

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

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

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

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

Balances held in each category at June 30, 2003 are as follows:

| | 1 | Categories 2 | 3 | Bank Balance | Carrying Amount |
|-----------------------------|----------------------|----------------------|----------------------|-----------------------|----------------------|
| Cash | \$ 36,676,184 | \$ - | \$85,256,745 | \$ 121,932,929 | \$114,350,063 |
| Certificates of Deposits | | 94,200,000 | - | 94,200,000 | 94,200,000 |
| | - | | - | | |
| | <u>\$ 36,676,184</u> | <u>\$ 94,200,000</u> | <u>\$ 85,256,745</u> | <u>\$ 216,132,929</u> | <u>\$208,550,063</u> |

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

Note 4 - Municipal license taxes

The Municipality imposes a volume of business tax pursuant to Act No. 82 of August 30, 1991, on all business entities, which operate within the Municipality, which are not exempt from the tax pursuant to the Industrial Incentives Act. The tax is based on gross revenues, as defined by law, computed at the rate of 1.5% for financial institutions and savings and loans associations, 0.5% for all other non-financial organizations.

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

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

The Municipality recognized an account receivable for the estimated municipal license taxes to be collected during the first three months of next year, but corresponding to current year. Municipal license taxes collected prior to June 30, but pertaining to the next fiscal year are recorded as deferred revenues.

Note 5 - Interfund transactions

Interfund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures. Following is a summary of interfund assets and liabilities as of June 30, 2003:

| | | |
|----------------------|----------------------|---------------------|
| Receivable Fund | Payable Fund | Amount |
| General | Debt Service | \$ 143,406 |
| | Economic Development | 580,675 |
| | Capital Project | 6,175,531 |
| | Other Governmental | <u>3,312,222</u> |
| | | <u>\$10,211,834</u> |
| Debt Service | Economic Development | <u>\$ 1,000</u> |
| Capital Project | General | \$ 1,932,806 |
| | Economic Development | <u>118,349</u> |
| | | <u>\$ 2,051,155</u> |
| Economic Development | General Fund | \$ 142 |
| | Other Governmental | <u>120,483</u> |
| | | <u>\$ 120,625</u> |
| Other Governmental | General Fund | \$ 36,894 |
| | Economic Development | 359,844 |
| | Other Governmental | <u>183,092</u> |
| | | <u>\$ 579,830</u> |

The interfund receivables and payables on Fund Financial Statements are eliminated on the Statement of Net Assets (Government Wide Financial Statements).

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003Note 6 - Intergovernmental revenues

Sources of intergovernmental revenue consist primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain "quasi-public" corporations, such as the Puerto Rico Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Almost all these intergovernmental revenues are accounted for in the general fund.

Note 7 - General long-term debt

The following is a summary of the long-term debt transactions for the year ended June 30, 2003:

| | <u>2003</u> | <u>2002</u> |
|--|-----------------------|-----------------------|
| Balance at beginning | \$ 167,084,260 | \$ 172,246,310 |
| Less: | | |
| Amount reclassified from Bonds Anticipation Note (BAN's) to proceeds from new issuance. | (3,805,130) | (1,037,270) |
| Adjusted Balance | 163,279,130 | 171,209,040 |
| Proceeds from new issuance | 58,714,870 | 1,248,000 |
| BAN's notes | 684,930 | 1,852,090 |
| Less current payments and maturities: | | |
| Bonds \$10,173,000 | | |
| Notes 1,700,000 | (11,873,000) | (11,030,000) |
| Adjustment from refinancing | (4,200,000) | - |
| Balance at June 30, 2003 | <u>\$ 206,605,930</u> | <u>\$ 163,279,130</u> |

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

General long-term debt as of June 30, 2003 consists of the following:

| | <u>2003</u> | <u>2002</u> |
|--|-------------|-------------|
| <u>Bonds</u> | | |
| Series of 2003 - \$4,000,000 payable in annual installments of \$90,000 to \$259,000 until July 1, 2027 with interest at 4.50% | \$3,910,000 | \$ - |
| Series of 2003 - \$1,310,000 payable in annual installments of \$20,000 to \$105,000 until July 1, 2027; with interest at 6.50%. | 1,290,000 | - |
| Series of 2003 - \$23,500,000 payable in annual installments of \$395,000 to \$1,810,000 until January 1, 2027; with interest at 5.60%. | 23,105,000 | - |
| Series of 2003 - \$5,040,000 payable in annual installments of \$95,000 to \$365,000 until July 1, 2027; with interest at 5.04% . | 4,945,000 | - |
| Series of 2003 - \$4,310,000 payable in annual installments of \$75,000 to \$330,000 until July 1, 2027; with interest at 5.60% | 4,235,000 | - |
| Series of 2003 - \$23,000,000 payable in annual installments of \$445,000 to \$1,625,000 until July 1, 2027; with interest at 5.5%. | 22,555,000 | - |
| Series of 2003 - \$1,360,000 payable in annual installments of \$31,000 to \$88,000 until January 1, 2028; with interest at 4.50%. | 1,360,000 | - |
| Series of 2001 - \$20,120,000 payable in annual installments of \$480,000 to \$1,805,000 until July 1, 2020 with interest at 5.34 to 5.29% | 18,575,000 | 19,125,000 |

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)

JUNE 30, 2003

| | <u>2003</u> | <u>2002</u> |
|---|-------------|-------------|
| Series of 2000 - \$30,285,000 payable in annual installments of \$1,020,000 to \$2,400,000 until July 1, 2017; with interest at 2.70 to 5.01%. | 25,865,000 | 27,060,000 |
| Series of 1999 - \$23,890,000 payable in annual installments of \$280,000 to \$1,860,000 until January 1, 2024; with interest at 5.35% to 6.1%. | 22,165,000 | 22,675,000 |
| Series of 1998 - \$13,165,000 payable in annual installments of \$210,000 to \$1,175,000 until July 1, 2020; with interest at 5.19% to 6.56%. | 11,585,000 | 11,905,000 |
| Series of 1991 - \$20,945,000 payable in annual installments of \$685,000 to \$2,450,000 until July 1, 2005; with interest at 6.163% to 6.3 13% | 4,685,000 | 6,725,000 |
| Series of 1994 - \$7,320,000 payable in annual installments of \$270,000 to \$790,000 until July 1, 2008; with interest at 7.106% to 7.606%. | 3,415,000 | 3,955,000 |
| Series of 1993 - \$21,260,000 payable in annual installments of \$845,000 to \$2,450,000 until July 1, 2007; with interest at 7.106% to 7.506%. | 8,700,000 | 10,465,000 |

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

| | <u>2003</u> | <u>2002</u> |
|---|-----------------------------|-----------------------------|
| Series 97 - \$1,248,000 payable in annual installments of \$100,000 to \$152,000 until January 1, 2011; with interest at 4.750%. | 1,043,000 | 1,148,000 |
| Series of 1994 - \$2,035,000 payable in annual installments of \$75,000 to \$220,000 until July 1, 2009; with interest at 7.106% to 7.706%. | 1,100,000 | 1,240,000 |
| Series of 1995 - \$11,885,000 payable in annual installments of \$440,000 to \$1,285,000 until July 1, 2009; with interest at 7.106% to 7.706%. | 6,415,000 | 7,225,000 |
| Series of 1992 - \$1,550,000 payable in annual installments of \$94,000 to \$172,000 until January 1, 2007; with interest at 5.625%. | 633,000 | 771,000 |
| Series of 1995 - \$16,630,000 payable in annual installments of \$250,000 to \$1,465,000 until July 1, 2019; with interest at 5.70% to 6.63%. | 13,980,000 | 14,405,000 |
| Series of 1996 - \$10,475,000 payable in annual installments of \$255,000 to \$1,010,000 until July 1, 2015; with interest at 5.70% to 6.58%. | 8,215,000 | 8,615,000 |
| Series of 1997 - \$2,370,000 payable in annual installments of \$30,000 to \$205,000 until July 1, 2022; with interest at 5.19% to 6.56%. | 2,130,000 | 2,180,000 |
| Series of 1980 - \$991,000 payable in annual installments of \$21,000 to \$65,000 until January 1, 2004; with interest at 5%. | <u>65,000</u> | <u>130,000</u> |
| Total General Debt – Bonds | <u>\$189,971,000</u> | <u>\$137,624,000</u> |

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

| | <u>2003</u> | <u>2002</u> |
|--|----------------------|----------------------|
| <u>Federal Notes</u> | | |
| Series of 2001- \$14,300,000 Loan guarantee federal program payable in installments of \$715,000 to \$2,145,000 until August 1, 2020 with variable interest rates. | \$14,300,000 | \$14,300,000 |
| During the fiscal year 2002-2003, the Municipality had issued Bond Anticipation Notes (BAN's) in the amount of \$684,930 and \$449,960 on fiscal year 2001-02 (net of amount refinancing by issuing general obligation bond). The Municipality intends to refinance these BAN's on a long-term basis with the Governmental Development Bank of Puerto Rico(GDB), which does not expire within one year from the date of the combined balance sheet. The refinancing will be done by issuing general obligation bonds of \$1,450,000. | 1,134,890 | 4,255,130 |
| Series of 1995 - \$8,000,000 Loan guarantee federal program payable in installments of \$600,000 to \$1,200,000 until August 1, 2003, with interest at 5.04% to 8.27%. | <u>1,200,000</u> | <u>2,900,000</u> |
| Total federal notes | <u>\$ 16,634,890</u> | <u>\$ 21,455,090</u> |
| Total debt of governmental activities | \$206,605,930 | \$163,279,130 |
| Less current portion due in fiscal year ended June 30, 2004 and 2003 | <u>(14,340,000)</u> | <u>(11,803,000)</u> |
| Long-term portion | <u>\$192,265,930</u> | <u>\$151,476,130</u> |

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

The annual requirements to amortize the general long-term bonds and notes at June 30, 2002, including payment of interest are as follows:

| <u>Year</u> | <u>Principal</u> | <u>Interests</u> | <u>Total</u> |
|-----------------|-----------------------|-----------------------|-----------------------|
| 2004 | \$ 14,340,000 | \$ 11,394,004 | \$ 25,734,004 |
| 2005 | 12,504,000 | 10,676,301 | 23,180,301 |
| 2006 | 10,733,000 | 9,960,843 | 20,693,843 |
| 2007 | 11,466,000 | 9,345,314 | 20,811,314 |
| 2008 | 9,396,000 | 8,676,217 | 18,072,217 |
| 2009-2013 | 44,089,000 | 36,093,293 | 80,182,293 |
| 2014-2018 | 50,157,000 | 23,114,758 | 73,271,758 |
| 2019-2023 | 34,010,000 | 10,082,072 | 44,092,072 |
| 2024-2028 | | | |
| including BAN's | <u>19,910,930</u> | <u>2,437,762</u> | <u>22,348,692</u> |
| Totals | <u>\$ 206,605,930</u> | <u>\$ 121,780,564</u> | <u>\$ 328,386,494</u> |

The original loan guarantee notes payable of \$22,300,000, with an outstanding balance of \$17,200,000, are collateralized with U.S. obligation by a federal financing institution, and real property acquired or to be acquired with these funds

Note 8 - Debt service fund

The revenues of the debt service fund arise from the additional property tax and are recognized when collected and informed by the CRIM (See Note 2). The CRIM retains these collections for the payment of principal and interest of bonds and notes issued by the Municipality. Interest income is for the payment of interest or special obligation notes and property taxes are for the debt service requirements of the general obligations bonds and notes.

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2002

Note 9 – Capital assets

Fund Financial Statements

The Municipality charged costs of capital outlays as expenditures categories in the Governmental Fund Financial Statements.

Government Wide Financial Statements

Capital assets purchased are carried at historical costs. Donated assets are recorded at fair value as of the date of donation. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation on capital assets is calculated using the straight-line method over the following estimated useful lives:

| <u>Asset Class</u> | <u>Estimated Useful Lives</u> | <u>Capitalization Threshold</u> |
|-----------------------------------|-------------------------------|---------------------------------|
| Vehicles, Heavy Equipment | 4-10 | \$300 |
| Furniture and Fixture | 10 | \$300 |
| Computer and Electronic Equipment | 5 | \$300 |
| Buildings | 50 | \$1 |
| Infrastructure | 60 | \$1 |
| Improvements | 20-40 | \$1 |

In addition, the Municipality assigned a 10% residual value on most Capital Assets.

| <u>Capital Assets</u> | <u>Balances 6/30/02</u> | <u>Additions</u> | <u>Retirements, Disposition and Transfers</u> | <u>Balances 6/30/03</u> |
|-------------------------------------|-------------------------|---------------------|---|-------------------------|
| Governmental Activities: | | | | |
| Non-depreciable assets: | | | | |
| Land | \$51,146,817 | \$39,335,122 | \$ - | \$90,481,939 |
| Construction in progress | <u>18,564,334</u> | <u>16,139,639</u> | - | <u>34,703,973</u> |
| Sub-totals | 69,711,151 | 55,474,761 | - | 125,185,912 |
| Infrastructure in progress | <u>11,662,074</u> | <u>6,054,294</u> | - | <u>17,716,368</u> |
| Total Non-depreciable assets | <u>\$81,373,225</u> | <u>\$61,529,055</u> | <u>\$ -</u> | <u>\$142,902,280</u> |

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)

JUNE 30, 2003

| Capital Assets | Balances 6/30/02 | Additions | Retirements Disposition and Transfers | Balances 6/30/03 |
|---|----------------------|--------------------|---|----------------------|
| Governmental Activities: | | | | |
| Depreciable assets: | | | | |
| Building and improvements: | \$134,885,702 | \$ - | \$ - | \$134,885,702 |
| Vehicles, equipment, furniture & fixtures | <u>20,279,553</u> | <u>1,559,413</u> | <u>(227,918)</u> | <u>21,611,048</u> |
| Sub-totals | <u>155,165,255</u> | <u>1,559,413</u> | <u>(227,918)</u> | <u>156,496,750</u> |
| Less accumulated depreciation | <u>(22,760,997)</u> | <u>(3,274,584)</u> | <u>227,918</u> | <u>25,807,663</u> |
| Depreciable assets, net | <u>132,404,258</u> | <u>(1,715,171)</u> | <u>-</u> | <u>130,689,087</u> |
| Business Type Activities: | | | | |
| Non-depreciable assets: | | | | |
| Land | <u>2,844,000</u> | <u>-</u> | <u>-</u> | <u>2,844,000</u> |
| Depreciable assets: | | | | |
| Buildings and infrastructure | 14,493,800 | - | - | \$ 14,493,800 |
| Equipment | <u>467,600</u> | <u>-</u> | <u>-</u> | <u>467,600</u> |
| Sub-total | <u>14,961,400</u> | <u>-</u> | <u>-</u> | <u>\$ 14,961,400</u> |
| Less accumulated depreciation | <u>(3,558,058)</u> | <u>(50,088)</u> | <u>-</u> | <u>(3,608,146)</u> |
| Depreciable assets, net | <u>\$ 11,403,342</u> | <u>\$ (50,088)</u> | <u>\$ -</u> | <u>\$ 11,353,254</u> |
| | | | | |
| | Balances 6/30/01 | Additions | Retirements Disposition and Transfers | Balances 6/30/02 |
| Governmental Activities: | | | | |
| Non-depreciable assets: | | | | |
| Land: | \$47,319,801 | \$ 3,827,016 | \$ - | \$51,146,817 |
| Construction in progress | <u>10,576,497</u> | <u>7,987,837</u> | <u>-</u> | <u>18,564,334</u> |
| Sub-totals | <u>57,896,298</u> | <u>11,814,853</u> | <u>=</u> | <u>69,711,151</u> |
| Infrastructure in progress | <u>-</u> | <u>11,662,074</u> | <u>-</u> | <u>11,662,074</u> |
| Total non-depreciable assets | <u>57,896,298</u> | <u>23,476,927</u> | <u>-</u> | <u>81,373,225</u> |
| Depreciable assets: | | | | |
| Buildings and improvements | 127,807,992 | 7,077,710 | - | 134,885,702 |
| Vehicles, equipment, furniture: and fixtures | <u>19,032,166</u> | <u>1,247,387</u> | <u>-</u> | <u>20,279,553</u> |
| Equipment | <u>467,600</u> | <u>-</u> | <u>-</u> | <u>467,600</u> |
| Sub-total | <u>146,840,158</u> | <u>8,325,097</u> | <u>-</u> | <u>155,165,255</u> |
| Less accumulated depreciation | <u>(19,868,632)</u> | <u>(2,892,365)</u> | <u>-</u> | <u>(22,760,997)</u> |
| Depreciable assets, net | <u>126,971,526</u> | <u>5,432,732</u> | <u>-</u> | <u>132,404,258</u> |
| Business Activities: | | | | |
| Non-depreciable assets: | | | | |
| Land | <u>1,870,000</u> | <u>\$ 974,000</u> | <u>\$ -</u> | <u>\$2,844,000</u> |
| Depreciable assets: | | | | |
| Buildings and infrastructure | 11,989,400 | 2,504,400 | - | 14,493,800 |
| Equipment | <u>467,600</u> | <u>-</u> | <u>-</u> | <u>467,600</u> |
| Sub-total | <u>12,457,000</u> | <u>2,504,400</u> | <u>-</u> | <u>14,961,400</u> |
| Less accumulated depreciation | <u>(2,722,206)</u> | <u>(835,852)</u> | <u>-</u> | <u>(3,558,058)</u> |
| Depreciable assets, net | <u>\$9,734,794</u> | <u>\$1,668,548</u> | <u>\$ -</u> | <u>\$11,403,342</u> |

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Depreciation expense charged to functions in June 30, is as follows:

| | <u>2003</u> | <u>2002</u> |
|------------------------|---------------------|---------------------|
| General Government | \$ 917,725 | \$ 835,114 |
| Economic Development | 2,251 | 7,361 |
| Welfare | 8,077 | 1,146 |
| Housing | 111,894 | 6,076 |
| Transportation | 747,336 | 101,402 |
| Recreation and Sports | 149,335 | 671,208 |
| Education and Training | 590,812 | 337,782 |
| Employment Opportunity | 196,071 | 41,120 |
| Sanitation | 277,507 | 142,419 |
| Public Safety | 194,150 | 536,533 |
| Health | 79,426 | 253,324 |
| Total | <u>\$ 3,274,584</u> | <u>\$ 2,933,485</u> |

The Municipality is organizing its personal property records to determine the amount invested in capital assets. This process requires the identification of personal property through physical inventories and their subsequent valuation. Once this process is completed, the Municipality will determine the correct amount of its investment in capital assets recorded in the Statement of Net Assets. The Municipality has substantially completed the process at June 30, 2003.

Note 10 - Retirement system

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

Commonwealth legislation required employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participants' gross salary. Total employer and employee contributions during the year ended June 30, 2003 and 2002 amounted to approximately \$ 2,644,000 and \$2,261,000, respectively.

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

On September 24, 1999, an amendment to Act No. 447 of May 15, 1991, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining on or after January 1, 2000 will only be allowed to become members of the System 2000. System 2000 will reduce the retirement age from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by the System together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employees' salary up to a maximum of 10%) will be invested in account which either; (1) earn a fixed rate based on the two year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

For the year ended June 30, 2003 and 2002, total covered payroll was approximately \$28,28,508,000 and \$28,083,000, respectively. Covered payroll refers to all compensation paid by the Municipality to employees covered by the ERS on which contributions to the pension are based.

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

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

Actuarial Valuation:

The actuarial determined present value of benefits accrued as of July 1, 2000 (latest date available) for the System as whole, determined through an actuarial valuation performed at such date, amounted to \$9.5 billion. The net assets available for benefits at such date were \$2.1 billion, resulting in an excess of accrued benefits over net assets available (actuarial deficiency) of \$7.4 billion. This information is not available by each participant government agencies nor municipalities. Net assets of the System consist principally of investments in stocks and bonds and loans to participants. The projected unit credit actuarial cost method was used for the actuarial calculation. Significant assumptions were as follows:

| | |
|--|---|
| a) Interest rate | 8.5% a year |
| b) Salary increases | 5.0% a year |
| c) Mortality | GAM'83 Mortality Table set forward two years. |
| d) Termination | Medium Turnover Table commensurate with anticipated experience. |
| e) Disability | 65% of Third Railroad Retirement Table Rates. |
| l) Retirement age | Graded scale of retirement ages commensurate with anticipated experience. |
| g) Proportion of participants with spouses | 80% of participants assumed to be married, with wives assumed to be four years younger than husbands. |
| h) Number of employees electing higher contributions | 15% of retiring employees assumed to pay retroactive contributions at retirement. |
| i) Cost-of-living adjustment | 3% every third year |

Note 11 - Compensated absences

The liability for compensated absences was reported in the government-wide financial statements. The balance consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which sick leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

MUNICIPALITY OF CAROLINA, PUERTO RICO
 NOTES TO FINANCIAL STATEMENTS (continued)
 JUNE 30, 2003

The changes in compensated absences for the year ended June 30, 2003 and 2002 are as follows:

| <u>Balance</u> <u>June 30, 2002</u> | <u>Net</u> <u>Decrease</u> | <u>Balance</u> <u>June 30, 2003</u> |
|--|-------------------------------|--|
| \$ 7,617,134 | \$3,285,783 | \$ 4,331,351 |
| <u>Balance</u> <u>June 30, 2001</u> | <u>Net</u> <u>Decrease</u> | <u>Balance</u> <u>June 30, 2002</u> |
| \$ 6,679,393 | \$ 847,741 | \$ 7,617,134 |

Note 12 - Leases

Operating Leases

The Municipality has several short-term operating lease agreements covering some of the Municipality's premises and equipment. All of the agreements are renewed annually, except for the Employment Opportunity Municipal Agency. Total rental charges for the year ended June 30, 2003, were approximately \$8,754,000 in all funds.

The future payments for the following fiscal years subsequent to June 30, 2003, corresponding to the Employment Opportunity Municipal Agency are the following:

| | |
|------|--------------------|
| 2004 | \$ 617,904 |
| 2005 | <u>100,770</u> |
| | <u>\$1,036,676</u> |

Direct Financial Leases

The Municipality acquired two real properties (See Note 1) on December 16, 1991. One of the properties and a portion of the other have been classified as direct financing leases expiring in eighteen and twenty years, respectively.

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003

These financial leases consist of the following at June 30, 2003:

| | <u>2003</u> | <u>2002</u> |
|--|---------------------|---------------------|
| Total minimum lease payments to be received | \$ 11,770,544 | \$ 13,402,460 |
| Less unearned interest income | <u>(4,983,886)</u> | <u>(6,176,959)</u> |
| Net investment in direct financing leases | <u>\$ 6,786,658</u> | <u>\$ 7,225,501</u> |

The minimum lease payments including interests for each of the five succeeding fiscal years are as follows:

| <u>Year</u> | <u>Principal</u> | <u>Interests</u> | <u>Total</u> |
|---------------------|---------------------|---------------------|----------------------|
| 2004 | \$ 519,389 | \$ 1,112,527 | \$ 1,631,916 |
| 2005 | 656,937 | 1,014,580 | 1,671,517 |
| 2006 | 786,690 | 892,746 | 1,679,436 |
| 2007 | 931,080 | 748,356 | 1,679,436 |
| 2008 and thereafter | <u>3,892,562</u> | <u>1,215,677</u> | <u>5,108,239</u> |
| Total | <u>\$ 6,786,658</u> | <u>\$ 4,983,886</u> | <u>\$ 11,770,544</u> |

Note 13- Contingencies and CommitmentsA. Litigation

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of \$1,642,057 in the government-wide statements for anticipated unfavorable judgments.

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

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2003**B. Federal financial assistance**

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

C. Construction projects

The Municipality has construction commitments for which the Municipality is obligated to an amount of approximately \$79 millions. These are commitments for the improvements of recreational and cultural facilities and for streets and general developments.

Note 14 – Healthcare costs

During the year ended June 30, 2000 the Governor of the Commonwealth of Puerto Rico imposed to the municipalities of Puerto Rico an annual contribution to subsidy the cost of the implementation and administration of the Healthcare Reform. Such contributions are required to be disbursed from general fund operating budget. Total contributions made by the Municipality amounted to \$7,853,847 and \$7,884,506 for the fiscal years ended June 30, 2003 and 2002, respectively.

Note 15 - Prior period adjustments**Fund statements**

The Municipality restated the beginning fund balance at July 1, 2002 by \$7,808,387 due to an understatement of total construction costs for the fiscal year ended June 30, 2002, which consisted of \$203,887 and \$7,616,500 for general and capital project fund respectively and an understatement in revenues in other governmental funds by \$12,000.

Government-wide statements

The Municipality restated beginning net assets at July 1, 2002 by \$24,703,196 due to an understatement in total capital assets at June 30, 2002 by \$23,203,196 and an overstatement in accrued landfill costs by \$1,500,000.

MUNICIPALITY OF CAROLINA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS (continued)

JUNE 30, 2003

Note 16 - Closure and post-closure care cost of landfill

The Municipality owns and operates a solid waste landfill. The state and federal laws and regulations require the Municipality to estimate the total current cost of Municipal Solid Waste Landfill Closure and Post-Closure Care Costs. The Municipality recognized \$4,607,300 and \$6,107,300 at June 30, 2003 and 2002, respectively as the estimated obligation for landfill closure and approximately \$64,000 annually for post-closure costs. Actual costs may be higher due to inflation changes in technology or changes in regulations. The amount was reported in the Statement of Net Assets at June 30, 2003. The Municipality expects to finance this obligation with the issuance of general obligation bonds.

Note 17 - Subsequent eventsA. Intergovernmental Revenues

During July 2003, the Court determined a favorable outcome to the Municipalities of Puerto Rico in a lawsuit between them and the Puerto Rico Electric Power Authority. The amount of revenue for the Municipality amounted to approximately \$3.4 million.

In addition in November 2003, the Municipal Revenue Collection Center transferred to the Municipality excess cash from the Municipal Redemption Fund of \$9 million.

B. Debt for Construction and Capital Improvement Projects

The Municipality is in process of obtaining a new financing agreement for the issuance of \$15,550,000 bonds for the construction and capital improvement projects for community and economic development.

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DE ASUNTOS MUNICIPALES

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SINGLE AUDIT PACKAGE
MUNICIPALITY OF CAROLINA

Fiscal Year Ended
June 30, 2003

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Auditors and Consultants

1056 Muñoz Rivera Avenue
Suite 304
San Juan, PR 00927-5013
Telephone: (787) 754-6615
Telefax: (787) 765-9405
E-Mail: pkfpr@pkfpr.com

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

Hon. José E. Aponte De la Torre
Mayor
Commonwealth of Puerto Rico
Municipality of Carolina

We have audited the basic financial statements of the Municipality of Carolina as of and for the year ended June 30, 2003 and have issued our qualified report, regarding personal capital assets thereon dated January 27, 2004. 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 of America.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Carolina's 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying schedule of findings and questioned costs as item 2003-2.

Internal control over financial reporting

In planning and performing our audit, we considered the Municipality of Carolina'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.

PANNELL KERR FORSTER, LLP

Hon. José E. Aponte De la Torre
Mayor
Commonwealth of Puerto Rico
Municipality of Carolina
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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 of Carolina'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 2003-1 and 2003-2.

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 reportable conditions that are also considered to be material weaknesses. However, we consider the reportable conditions described above to be material weaknesses.

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



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Auditors and Consultants

1056 Muñoz Rivera Avenue
Suite 304
San Juan, PR 00927-5013
Telephone: (787) 754-6615
Telefax: (787) 765-9405
E-Mail: pkfpr@pkfpr.com

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

Hon. José E. Aponte De la Torre
Mayor
Commonwealth of Puerto Rico
Municipality of Carolina

Compliance

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

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

Pannell Kerr Forster, LLP

Hon. José E. Aponte De la Torre
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Commonwealth of Puerto Rico
Municipality of Carolina
Page 2

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

As described in item 2003-3 in the accompanying schedule of findings and questioned costs, the Municipality of Carolina did not comply with requirements regarding equipment and real property management that is applicable to its Community Development Block Grant, Home Investment Partnerships, Child Care, and Head Start federal programs. Compliance with such requirements is necessary, in our opinion, for the Municipality of Carolina to comply with requirements applicable to those programs

As described in item 2003-4 in the accompanying schedule of findings and questioned costs, the Municipality of Carolina did not comply with Special Provision that is applicable to is Section 8 Housing Choice Voucher Federal Program. Compliance with such requirement is necessary, in our opinion for the Municipality of Carolina to comply with requirements applicable to those programs..

As described in item 2003-5 in the accompanying schedule of findings and questioned costs, the Municipality of Carolina did not comply with requirements regarding cash management that is applicable to its Head Start federal program. Compliance with such requirement is necessary, in our opinion, for the Municipality of Carolina to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraphs, the Municipality of Carolina complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2003.

Internal control over compliance

The management of the Municipality of Carolina is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Hon. José E. Aponte De la Torre
Mayor
Commonwealth of Puerto Rico
Municipality of Carolina
Page 3

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 Example Entity'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 2003-3, 2003-4 and 2003-5.

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 2003-3 to be material weaknesses.

Schedule of expenditures of federal awards

We have audited the basic financial statements of the Municipality of Carolina as of and for the fiscal year ended June 30, 2003, and have issued our report thereon dated January 27, 2004. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Hon. José E. Aponte De la Torre
Mayor
Commonwealth of Puerto Rico
Municipality of Carolina
Page 4

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



March 26, 2004

Pannell Kerr Forster

License No. 22

Expires on December 1, 2004

Pannell Kerr Forster, LLP

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the Fiscal Year Ended June 30, 2003

SECTION 1 – SUMMARY OF AUDITOR'S RESULTS

Financial Statements:

Type of auditor's report issued: Qualified

Internal control over financial reporting:

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

Federal awards:

Internal control over major programs:

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

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

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510 (a)? Yes

Identification of major programs:

| <u>CFDA Number(s)</u> | <u>Name of Federal Program or Cluster</u> |
|--|--|
| 14.218 | Community Development Block Grant Entitlement |
| 93.600 | Head Start Administration for Youth and Children |
| 14.239 | Home Investment Partnerships Program |
| 14.871 | Section 8 Housing Choice Voucher |
| 10.766 | USDA Rural Guarantee Loan for Water and Sewing Project |
| 93.575 | Child Care Grant Pass-through the Puerto Rico Department of the Family |
| Dollar threshold used to distinguish between Type A and Type B programs: | \$513,593 |
| Auditee qualified as a low-risk auditee? | No |

SECTION 2 – FINANCIAL STATEMENT FINDINGS

Finding No. 2003-1

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

Condition: At June 30, 2003 the balances of inter-fund receivables, payables, deferred revenues, and fund balances in the SAP System were not reconciled with their subsidiaries.

Criteria: Puerto Rico Municipality Law (Law 81), article number 8.010, establishes that the municipalities should maintain an accounting system that is in accordance with generally accepted accounting principles. Specifically, the Puerto Rico municipalities should record their financial transactions using fund accounting.

In addition, the Governmental Accounting Standards Board Codification, Section 1300.110 establishes the following:

“.....because each fund is a fiscal and accounting entity, the amounts due to one fund from other funds, as well as the amounts owed to other funds, should be reflected in the fund accounts and in fund financial statements”.

Cause: At June 30, 2003, the Municipality maintained in the SAP System an account denominated *Clearing Account*, which is used basically to account differences found in the recording of journal entries that affect balance sheet accounts, including inter-fund transactions. However, the transactions recorded in the *Clearing Account* are not clearly identified in the SAP System and the Municipality depends on the use of manual accounting records and electronic spreadsheets to obtain more accurate information regarding the funds.

Effect: The balances in the SAP System of the balance sheet accounts already mentioned were not updated at June 30, 2003. Because of the *Clearing Account* design limitations the Municipality of Carolina has to maintain manual accounting records and electronic spreadsheets for each individual fund to ensure that the specific activities are carried and the objectives are attained in accordance with special regulations, restrictions, or limitations of such transactions.

Recommendation: Since article 8.010 of Law 81 permits OCAM to approve the design and implementation of other accounting systems besides the one developed by them, we suggest the Municipality's management to request such an authorization from OCAM. We also, suggest that the Municipality implements a financial accounting system that provides fiscal controls and accounting procedures that are:

1. In accordance with generally accepted accounting principles including:
 - a) Information pertaining to obligations, unobligated balances, assets, liabilities, expenditures, and income;
 - b) Effective internal controls to safeguard assets and assure their proper use;
 - c) A comparison of actual expenditures with budgeted amounts;
 - d) Source documentation to support accounting records; and
 - e) Proper charging of costs and cost allocation.

2. Sufficient to:
 - a) Permit the tracing of funds to a level of expenditures adequate to establish that funds have not been used in violation of the applicable restrictions on the use of such funds; and
 - b) Permit preparation of required reports, and financial statements in accordance with GASB 34 requirements.

Also, we suggest that the Municipality's Finance Department performs monthly monitoring procedures over the status of the inter-fund transactions. A matrix listing the receivable funds on the left and the payable funds across the top can be useful for monitoring the status of the inter-fund transactions.

An example of such a matrix is as follows:

INTERFUND TRANSACTION MATRIX

| <i>Receivable Funds</i> | <i>Payable Funds</i> | | | | <i>Total</i> |
|-------------------------|----------------------|---------------------|---------------------|---------------------|--------------|
| | <i>Major Fund 1</i> | <i>Major Fund 2</i> | <i>Major Fund 3</i> | <i>Major Fund 4</i> | |
| Major Fund 1 | XXX | | 5,000 | 5,000 | 10,000 |
| Major Fund 2 | 25,000 | XXX | 15,000 | | 40,000 |
| Major Fund 3 | | 10,000 | XXX | 10,000 | 20,000 |
| Major Fund 4 | | | 5,000 | XXX | 5,000 |
| Total | 25,000 | 10,000 | 25,000 | 15,000 | 75,000 |

Funds reading across are due money from each of the Payable Funds listed at the top. Funds reading down owe money to the Receivable Funds listed on the left. At the end of the month, all inter-fund accounts should be verified against the matrix to determine whether they are still in agreement.

END FINDING NO. 2003-1

Finding 2003-2

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

Condition: The subsidiary of personal property maintained in the Property Area at June 30, 2003, was not reconciled with the data per physical inventory. During our inspection of certain properties, we could not satisfy ourselves about the physical location of such properties.

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

The Revised Regulations of Basic Puerto Rico Municipalities Standards (the Regulations) issued by OCAM, establishes in its Chapter VII (Custody, Control and Accounting of Municipality Property, section 22 (Annual Physical Inventory) that every municipality should maintain an adequate control of its property by the taking of periodic physical inventories (annually). As soon as the inventory listings are prepared the employee in charge of the municipal property should trace the listing totals against the accounting records. If differences exist between the listings and the accounting records a reconciliation and investigation must be performed.

Also, the Chapter VII, section 20 of the Ruling, establishes that the property transfers must be approved by the employee in charge of property and that the transfers require the approval of the Finance Director or his/her authorized representative through the form OCAM-FA-04.

Cause: The employee in charge of property does not perform reconciliations between the total of personal property reported in the subsidiary of property, plant and equipment and the physical items.

In addition, the employee in charge of the Municipal property does not perform periodic reconciliations of the property ledger (listing) with the control account as required by the municipal regulations issued by OCAM. In addition, there is no adequate procedure regarding the receiving of personal property other than for computerized equipments and vehicles.

Effect:

1. We could not satisfy ourselves about the balance of personal property at June 30, 2003.

2. The Municipality is not in compliance with the municipal regulations issued by OCAM.
3. The Property control procedures in place do not ensure adequate safeguards to prevent any loss, damage, or theft of the Municipality's property.
4. The financial statements of the Municipality as of June 30, 2003 were qualified because we were unable to apply the required auditing procedures over the general capital assets.

Recommendation: The Finance Director should instruct the employee in charge of the property management to perform a physical inventory of personal property at June 30, 2004 and investigate any difference between data included in the subsidiary and the physical location.

Upon completion, the cost of these assets, adjusted for accumulated depreciation not previously recorded, will need to be determined and recorded in the accounting records. Depreciation expense must then be calculated and recorded along with the results of the inventory count. It is important that the Municipality maintains and update capital asset listings in a timely manner in order to properly calculate and record capital assets and related depreciation at year-end.

The Municipality should make the record keeping of the expenditures related to the personal property in the general capital assets when the expenditures are incurred.

The Municipality needs to analyze periodically the details of all expenditure accounts terminated in codification 93.01 and 93.27 (Office equipment), 93.11 (Municipal vehicles), 99.99 (Payments of prior years' encumbrances) and 94.65 (Miscellaneous) for all funds in order to ascertain if expenditures of property units reconciles with the additions in the subsidiary of capital assets.

END FINDING NO. 2003-2

SECTION 3 – FEDERAL AWARDS FINDINGS

Finding 2003-3

| | |
|-------------------------------|--|
| Program CFDA No. / Grant No.: | 14.219 Community Development Block Grant 93.600 Head Start Program 14.239 Home Investment Partnership Program 93.573 Child Care and Development Grant |
|-------------------------------|--|

| | |
|-------------------------------|--|
| Type of Reportable Condition: | Material Non-compliance – Equipment and real property management |
| Questioned Cost: | None |

Condition: The subsidiary of personal property maintained in the Property Area at June 30, 2003, was not reconciled with the data per physical inventory. During our inspection of certain properties, we could not satisfy ourselves about the physical location of such properties.

In addition, the property subsidiary maintained by the Child Care Program does not include the acquisition date of the units.

Criteria: Compliance Supplement of Circular A-133, Part 3, section F (Equipment and Property Management) establishes that the local governments shall follow the A-102 Common Rule for equipment acquired with federal awards.

Circular A-102, section .32(d)(2) establishes that a physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

Also, Circular A-102 (Common Rule), section .32 requires that property records must be maintained to include a description of property, serial number, or other identification number, the source of property, who holds the title, the acquisition date, cost of the property, percentage of federal participation in the cost of the property, percentage of federal participation in the cost of property and any ultimate disposition data including the date of disposal and sales price of the property.

45 CFR, part 92.32 establishes and 24 CFR part 85 establishes that property records must include the following information: (1) description of property, (2) serial number or other identification number, (3) source of property, (4) who holds title, (5) acquisition date, (6) cost, (7) percentage of federal participation, (8) location, (9) use and condition, and (10) ultimate disposition date including the date of disposal and sales price of property.

Cause: The employee in charge of property does not perform reconciliations between the total of personal property reported in the subsidiary of property, plant and equipment and the physical items.

In addition, the employee in charge of the Municipal property does not perform periodic reconciliations of the property ledger (listing) with the control account as required by the federal regulations issued by Circular A-102. In addition, there is no adequate procedure regarding the receiving of personal property other than computerized equipments and vehicles.

Effect:

1. We could not satisfy ourselves about the balance of personal property at June 30, 2003.
2. The Municipality is not in compliance with the municipal regulations issued by Circular A-102.
3. The Property control procedures in place do not ensure adequate safeguards to prevent any loss, damage, or theft of the Municipality's property.
4. The financial statements of the Municipality as of June 30, 2003 were qualified because we were unable to apply the required auditing procedures over the general capital assets.

Recommendation: The Finance Director should instruct to the employee in charge of the property management to perform a physical inventory of personal property at June 30, 2003 and investigate any differences between data included in the subsidiary and the physical location.

Upon completion, the cost of these assets, adjusted for accumulated depreciation not previously recorded, will need to be determined and recorded in the accounting records. Depreciation expense must then be calculated and recorded along with the results of the inventory count. It is important that the Municipality maintains and updates capital asset listings in a timely manner in order to properly calculate and record capital assets and related depreciation at year-end.

The Municipality should make the record keeping of the expenditures related to the personal property in the general capital assets when the expenditures are incurred.

The Municipality needs to analyze periodically the details of all expenditure accounts terminated in codification 93.01 and 93.27 (Office equipment), 93.11 (Municipal vehicles), 99.99 (Payments of prior years' encumbrances) and 94.65 (Miscellaneous) for all funds in order to ascertain if expenditures of property units reconciles with the additions in the subsidiary of capital assets.

Finding 2003-4

| | |
|-------------------------------|---|
| Program CFDA No. / Grant No.: | 14.871 Section 8 Housing Choice Voucher |
| Type of Reportable Condition: | Internal Control |
| Questioned Cost: | None |

Condition: The housing rental contracts are not signed by all the parties involved in the process of housing rental subsidy. The parties required for signing the contracts are the Municipality's representative, the property owner and the beneficiary of the subsidy.

Criteria: OMB Circular A-102, Subpart C, *Post award requirements*, paragraph .20-6 *Standards for financial management systems-Source documentation*, establishes that *accounting records must be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records, contract and sub-grant award documents, etc.*

Cause: Lack of proper care in the formalization of housing rental contracts.

Effect: This situation caused that the Municipality expended Section 8 funds without any guarantee of compliance and legal obligation by the owner and the tenant through the signature of the contracts.

Recommendation: We suggest that the Municipality, in order to make the rental contracts enforceable, requires from both the housing unit owners and the tenants, the signature of housing rental contracts as soon as the rental subsidy is approved by the Municipality's management.

END FINDING NO. 2003-4

Finding 2003-5

| | |
|-------------------------------|--|
| Program CFDA No. / Grant No.: | 93.600 Head Start and Early Head Start |
| Type of Reportable Condition: | Non-compliance – Cash Management |
| Questioned Cost: | None |

Condition: During fiscal year ended June 30, 2003, the Municipality did not minimize the timing between federal cash remittances and their corresponding disbursement to meet its immediate cash in 2 of 5 cases examined as follows:

Criteria: The Common Rule, Subpart A .20(7) establishes that procedures for minimizing the elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees' cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees.

Cause: The requests were made without verifying if the vendors submitted all of the required disbursement supporting documents (invoices and certifications). As a result the disbursement process was delayed.

Effect: In some instances the Municipality did not manage Federal cash effectively and was not in compliance with Common Rule.

Recommendation: To improve cash management, the Municipality should time their projected payments clearance patterns to coincide with the receipt of cash from the federal government. In order to improve cash management we suggest the Municipality the improvement of cash management procedures that include a payment policy and the establishment of a formal disbursement cycle for the program. Also, projections and timing are important for good cash management.

END FINDING NO. 2003-5

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

Finding 02-II-1

Audit Finding Description

We noted certain differences in reported transactions like subsidiary ledgers, payroll and obligations control accounts.

Audit Finding Status

A similar condition was described in Audit Finding 2003-1. Therefore condition still prevails.

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

Finding 02-III-1

Major Program

Section 8 Rentals.

Audit Finding Description

During our examination, we noted that Section 8 had advanced \$278,612 funds to HOPWA program without HUD authorization.

Audit Finding Status

Condition still prevails.

Finding 02-III-2

Major Programs

Community Development Block Grant (CDBG), USDA and Head Start Program.

Audit Finding Description

The OMB Circular A-133 (compliance C), requires that when the funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and program disbursement. Also, interest earned, over \$100 related to CDBG and USDA and \$250 to Head Start have not been reimbursed to the federal agencies.

Audit Finding Status

Conditions were corrected for all programs in terms of interest , but prevails for Head Start program in terms of the time elapsing between the transfer of funds and the program disbursement.

Finding 02-III-3**Major Program**

Head Start Program.

Audit Finding Description

For Head Start and Early Head Start Program, we found that the obligations were not paid within 90 days.

Audit Finding Status

Condition was corrected.

Finding 02-III-4**Major Program**

Head Start Program.

Audit Finding Description

Based on our examination, we noted, that the administrative expenditures files were incomplete to determine the appropriate percentage of administration expenditures.

Audit Finding Status

Condition was corrected.

Finding 02-III-5**Major Programs**

Community Development Block Grant (CDBG), USDA Loans and Head Start Program.

Audit Finding Description

During our examination, we were not provided with an accurate detail of inventory accounting records that reconciled with physical inventory records related to Head Start, Early Head Start and CDBG. Also, an inventory record, or investment in the "Acueducto Municipal" financed by an USDA Rural Development Loan, was not available for examination.

Audit Finding Status

The same situation is mentioned in Audit Findings 2003-2 and 2003-3. Therefore condition still prevails.

Finding 02-III-6**Major Programs**

Head Start and USDA Loan Programs.

Audit Finding Description

For Head Start and Early Head Start, FSR 272 for quarter ended on March 31, 2002, and June 30, 2002, were submitted 13 and 16 days, respectively, later than program regulations due dates. Also, the FSR 269 for Head and Early Head Start were not available for examination. In addition, we noted differences between submitted reports to federal agency and municipality accounting records for Head and Early Head Start program year 2001. For USDA Loans, municipality should submit loan financial statements before September of each year. Such statements were not available for examination.

Audit Finding Status

Condition still prevails for the USDA Loan Program.

Finding 01-II-1**Major Programs**

Head Start, UDSA Food and CDBG Programs.

Audit Finding Description

There are some differences among accounting details and their respective general ledgers on Head Start and USDA.

Audit Finding Status

Conditions were corrected.

Finding 01-III-1**Major Program**

Section 8 Rental Program.

Audit Finding Description

Questioned cost about \$271,193 of unauthorized transfers to HOPWA program without authorization of federal agency. Collect ability from HOPWA's grantor is uncertain.

Audit Finding Status

Condition still prevails.

Finding 01-III-2**Major Program**

CDBG, Section 8 Rental, USDA and Head Start.

Audit Finding Description

Time elapsing between draw-downs of funds and disbursements were not in accordance with federal regulations.

Audit Finding Status

Condition was corrected except for the Head Start Program.

Finding 01-III-3**Major Program**

CDBG, Section 8 Rental and USDA.

Audit Finding Description

Municipality failed to comply with reasonable studies for year newly units as required by Section 8 regulations. For USDA, inadequate internal control over food physical inventory was found. For CDBG the citizen participation plan and environmental review record for fiscal year 2000-2001 were not available for examination.

Audit Finding Status

Conditions were corrected.

Finding 01-III-4**Major Programs**

CDBG and Head Start.

Audit Finding Description

For Head Start, Administrative Personnel have not been paying the obligations incurred 90 days after year ended the closing. For CDBG, obligation balances over five years since grant approval were recorded amounting \$207,957.

Audit Finding Status

Condition was corrected.

Finding 01-III-5**Major Program**

Loan Guarantee.

Audit Finding Description

Municipality's management failed to verify that contractors comply with federal prevailing wages.

Audit Finding Status

Condition was corrected.

Finding 01-III-6**Major Program**

USDA Food Program.

Audit Finding Description

Earmarking expenditures percentages were not followed in the program.

Audit Finding Status

Condition was corrected.

Finding 01-III-7**Major Programs**

CDBG and Head Start.

Audit Finding Description

Municipality didn't have an accurate inventory purchased with federal funds.

Audit Finding Status

Condition still prevails. Similar situation is mentioned in Audit Finding 2003-3.

Finding 01-III-8**Major Programs**

CDBG and Head Start.

Audit Finding Description

Some of the required financial reports to be submitted were not comply with the time required by federal agencies. Also, some differences were found between financial reports submitted and financial records.

Audit Finding Status

Condition was corrected.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended June 30, 2003

| <u>Federal Grantor</u> | <u>Program Title</u> | <u>Federal CFDA Number</u> | <u>Grant Number</u> | <u>Expenditures</u> |
|---|---|------------------------------------|---------------------|---------------------|
| US Department of Agriculture | Community Facilities Loans and Grants | 10.766 | | \$1,050,771 |
| | Child Care Food Program Pass-through the Puerto Rico Department of Education | 10.588 | | 301,766 |
| | Nutrition Program for the Elderly | 10.570 | | 9,353 |
| US Department of Justice | Byrne Formula Grant | 16.579 | | 14,736 |
| | Law Enforcement Block Grant | 16.592 | | 125,932 |
| US Department of Health and Human Services | Head Start and Early Head Start | 93.600 | | 5,009,105 |
| | Elderly Commission-Special Program for Aging (Title III Part B) | 93.045 | | 108,293 |
| | Child Care Block Grant Pass-through the Puerto Rico Department of the Family | 93.575 | | 684,052 |
| US Department of Housing and Urban Development | Community Development Block Grant | 14.218 | | 5,137,360 |
| | Emergency Shelter Grant | 14.231 | | 246,358 |
| | Home Investment Partnership Program | 14.239 | | 917,909 |
| | Section 8 Housing Choice Vouchers | 14.871 | | 3,382,484 |
| | Housing Opportunities for Persons with Aids Program (HOPWA) | 14.241 | | 131,641 |
| Total Expenditures | | | | \$17,119,760 |

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended June 30, 2003

NOTE 1 – GENERAL

The accompanying schedule of expenditures of federal awards presents the expenditures, for the fiscal year ended June 30, 2003, of all the federal assisted programs of the Municipality of Carolina.

NOTE 2 – ACCOUNTING BASIS

The schedule was prepared following the modified accrual basis of accounting, which is further explained in note 1 of the basic financial statements of the Municipality of Carolina for the fiscal year ended June 30, 2003.

CORRECTIVE ACTION PLAN

| | |
|------------------|---|
| Contact Persons: | Mr. Edwin Lebrón González - Director of Finance Daniel Redón, CPA – Director of Internal Audit |
| Phone number: | (787) 757-2626 extension 410 |
| Fax: | (787) 276-0735 |

The Corrective Action Plan was prepared by the Municipality's management and is included separately of this document.

COMISIONADO
MUNICIPALES
04 APR -7. AM 8:13
RECIBIDO
UNIDAD DE CORREO

Caf 461-8013



GOBIERNO
MUNICIPAL DE
CAROLINA

March 24, 2004

Bureau of the Census
Single Audit Clearinghouse
1201 E. 10th St.
Jefferson Ville, IN 47132

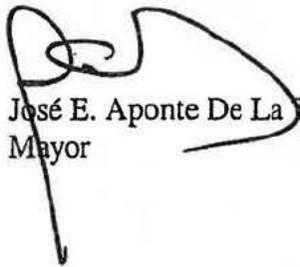
RE: Single Audit Report of the Municipality of Carolina for the year ended June 30, 2003

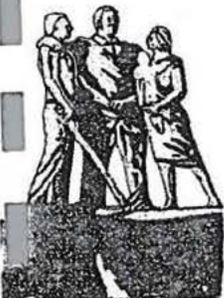
The following are the Financial Statement under the new format prescribed by the provision of Government Accounting Standard Board Statement 34 (GASB 34) and the Single Audit Package, that represent the Single Audit Report of the Autonomous Municipality of Carolina for the year ended June 30, 2003 as required by the Single Audit Act of 1984, as amended. The following report is included:

- a. Data Collection Form
- b. Five (5) copies of the Single Audit Report, including the schedule of Federal Awards prepared by the external auditors.
- c. Current year Corrective Action Plan

If you have any question about the Single Audit Report or need further information, contact the Municipality's Finance Director, Mr. Edwin Lebrón González, or Internal Auditor Director, Mr. Daniel Redón Santiago, at (787) 757-2626 ext. 490 or 361, respectively or addressed to: Municipality of Carolina, Office of the Mayor, P.O. Box 8, Carolina, P. R. 00986-0008.

Cordially,


 José E. Aponte De La Torre
 Mayor



COMMONWEALTH OF PUERTO RICO
Municipality of Carolina
Single Audit for the year ended June 30, 2003
Executive Summary

About the Single Audit

The Municipality of Carolina ("Municipality") participates in series of federal financial assistance programs to address the necessities of its growing population of more than 200,000 residents. These programs have been audited according to the Single Audit Act of 1984, as amended, and the US Office of Management and Budget (OMB) Circular A-133. The Municipality has the following major and non-major programs to assist the needs of low-income and moderate-income citizens according to the federal grantors.

Federal Grantor

US Department of Housing and Urban Development

- Community development Block Grant Program (CDBG), Entitlement Grant and Loan Guarantee
- Section 8- Housing Assistance Payments Program for Low- Income Families
- Housing Opportunities for Persons with Aids (HOPWA)
- HOME Investment Partnership Program
- Emergency Shelter Grant Program (ESG)

US Department of Health and Human Services

- Head Start and Early Head Start Program
- Special Program for Elderly
- Child Care Development Block Grant

US Department of Agriculture

- Nutrition Program for Elderly
- Child and Adults Care Food Program
- Community Facilities Loans and Grants

US Department of Justice

- Byrne Formula Grant Program (Victims of Crime Act)
- Law Enforcement Block Grant

These programs were audited by Pannell Kerr Forster, LLP, an independent firm of certified public accountants. The audit is a requirement described in the OMB Circular A-133 that are applicable to each of the major federal programs for the year ended June 30, 2003.

The audit was performed for the purpose of forming an opinion on the Municipality's basic financial statement under the provision of GASB Statement 34 taken as a whole.

COMMONWEALTH OF PUERTO RICO
Municipality of Carolina
Single Audit for the year ended June 30, 2003
Executive Summary

Auditors, examined on a test basis, evidence about the Municipal's compliance with those requirements. According to the Summary of Auditor's Results, the internal controls over the major programs did not identify material weakness.

In their examination, the auditors have detected some findings, which were discussed with the corresponding program officials. The Municipality has made the proper corrective action plan in order to comply with the recommendations of auditors and with federal regulation and procedures.

Development of the Single Audit

The audit of the programs followed various steps to obtain proper responses from the Municipality Management.

- ❖ External auditors examined selected programs and cases at random to identify if the Municipality had complied with federal statute and regulations and had made correct use of funds according to norms, regulations and accepted accounting principles.
- ❖ Information and data was requested to Municipality officials to sustain the different accounting transactions, fund balances and allocations.
- ❖ A preliminary draft containing the supposed finding was remitted to the program officials for a management response.
- ❖ After receiving a management response an alleged finding, auditors cleared our unheld the finding. A management draft of finding was remitted to municipal officers.
- ❖ Municipal officer met with auditors to discuss finding and elaborated a management response.
- ❖ The audit report, management response and corrective action plan are submitted to federal authorities.

Corrective Action Plan

In order to comply with federal regulations, the Municipality has the challenge to continue improvement the internal controls for the compliance with the regulations and laws.

COMMONWEALTH OF PUERTO RICO
Municipality of Carolina
Single Audit for the year ended June 30, 2003
Executive Summary

Comments to the Single Audit for the year ended in June 30, 2003

The Municipality has made a corrective action plan for the Single Audit Report of the year ended on June 30, 2003. Enclose find the corrective action plan consisting of finding, management response and corrective action plan.

FORM SF-SAC
(3-20-2001)

U.S. DEPT. OF COMM.- Econ. and Stat. Admin.- U.S. CENSUS BUREAU
ACTING AS COLLECTING AGENT FOR
OFFICE OF MANAGEMENT AND BUDGET

**Data Collection Form for Reporting on
AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS
for Fiscal Year Ending Dates On or After January 1, 2001**

Complete this form, as required by OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

RETURN TO Federal Audit Clearinghouse
1201 E. 10th Street
Jeffersonville, IN 47132

PART I GENERAL INFORMATION (To be completed by auditee, except for Item 7)

| | | | |
|---|--|---|--|
| 1. Fiscal period ending date for this submission Month / Day / Year Fiscal Period End Dates Must Be On or After January 1, 2001 06 / 30 / 2003 | | 2. Type of Circular A-133 audit 1 <input checked="" type="checkbox"/> Single audit 2 <input type="checkbox"/> Program-specific audit | |
| 3. Audit period covered 1 <input checked="" type="checkbox"/> Annual 2 <input type="checkbox"/> Biennial 3 <input type="checkbox"/> Other - Months | | FEDERAL GOVERNMENT USE ONLY | 4. Date received by Federal clearinghouse |
| 5. Employer Identification Number (EIN) a. Auditee EIN 6 6 0 4 3 3 5 3 9 | | | b. Are multiple EINs covered in this report? 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No If Part I, Item 5b = "Yes," complete Part I, Item 5c (Complete the continuation sheet on Page 4) |

6. AUDITEE INFORMATION

a. Auditee name
MUNICIPALITY OF CAROLINA

b. Auditee address (Number and street)
PO BOX 8
City
CAROLINA
State ZIP + 4 Code
PR 0 0 9 8 6 - 0 0 0 8

c. Auditee contact
Name
EDWIN LEBRON GONZALEZ
Title
FINANCE DIRECTOR

d. Auditee contact telephone
(787) 757 - 2626

e. Auditee contact FAX (Optional)
(787) 762 - 7999

f. Auditee contact E-mail (Optional)
ELEBRON@CAROLINA.GOV.PR

7. AUDITOR INFORMATION (To be completed by auditor)

a. Auditor name
PANNELL KERR FORSTER, LLP

b. Auditor address (Number and street)
1056 MUNOZ RIVERA AVE SUITE 304
City
SAN JUAN
State ZIP + 4 Code
PR 0 0 9 2 7 - 5 0 1 3

c. Auditor contact
Name
EDWIN TORRES CASTRO
Title
PARTNER

d. Auditor contact telephone
(787) 754 - 6675

e. Auditor contact FAX (Optional)
(787) 765 - 9405

f. Auditor contact E-mail (Optional)
ETORRES@PKFPR.COM

g. AUDITEE CERTIFICATION STATEMENT - This is to certify that, to the best of my knowledge and belief, the auditee has: (1) engaged an auditor to perform an audit in accordance with the provisions of OMB Circular A-133 for the period described in Part I, Items 1 and 3; (2) the auditor has completed such audit and presented a signed audit report which states that the audit was conducted in accordance with the provisions of the Circular; and, (3) the information included in Parts I, II, and III of this data collection form is accurate and complete. I declare that the foregoing is true and correct.

g. AUDITOR STATEMENT - The data elements and information included in this form are limited to those prescribed by OMB Circular A-133. The information included in Parts II and III of the form, except for Part III, Items 8, 9, and 10, was transferred from the auditor's report(s) for the period described in Part I, Items 1 and 3, and is not a substitute for such reports. The auditor has not performed any auditing procedures since the date of the auditor's report(s). A copy of the reporting package required by OMB Circular A-133, which includes the complete auditor's report(s), is available in its entirety from the auditee at the address provided in Part I of this form. As required by OMB Circular A-133, the information in Parts II and III of this form was entered in this form by the auditor based on information included in the reporting package. The auditor has not performed any additional auditing procedures in connection with the completion of this form.

Signature of certifying official Date
Month Day Year
Director of Finance 3 / 30 / 2004
Printed Name/Title of certifying official

Signature of auditor Date
Month Day Year
3 / 30 / 2004

PART I GENERAL INFORMATION - Continued

8. Did the auditee expend more than \$25,000,000 in Federal awards during the fiscal year? (Mark (X) one box)
1 Yes - Identify Cognizant Agency in Part I, Item 9 2 No - SKIP to Part II, Item 1

9. Indicate which Federal awarding agency provided the predominant amount of direct funding in fiscal year 2000. (Mark (X) one box) However, if cognizance has been reassigned, see instructions.

- | | | | |
|--|---|---|---|
| 02 <input type="checkbox"/> Agency for International Development | 81 <input type="checkbox"/> Energy | 14 <input type="checkbox"/> Housing and Urban Development | 47 <input type="checkbox"/> National Science Foundation |
| 10 <input type="checkbox"/> Agriculture | 66 <input type="checkbox"/> Environmental Protection Agency | 15 <input type="checkbox"/> Interior | 20 <input type="checkbox"/> Transportation |
| 11 <input type="checkbox"/> Commerce | 83 <input type="checkbox"/> Federal Emergency Management Agency | 16 <input type="checkbox"/> Justice | <input type="checkbox"/> Other - Specify: |
| 12 <input type="checkbox"/> Defense | 93 <input type="checkbox"/> Health and Human Services | 17 <input type="checkbox"/> Labor | |
| 84 <input type="checkbox"/> Education | | | |

PART II FINANCIAL STATEMENTS (To be completed by auditor)

1. Type of audit report (Mark (X) one box)
1 Unqualified opinion 2 Qualified opinion 3 Adverse opinion 4 Disclaimer of opinion
2. Is a "going concern" explanatory paragraph included in the audit report? 1 Yes 2 No
3. Is a reportable condition disclosed? 1 Yes 2 No - SKIP to Item 5
4. Is any reportable condition reported as a material weakness? 1 Yes 2 No
5. Is a material noncompliance disclosed? 1 Yes 2 No

PART III FEDERAL PROGRAMS (To be completed by auditor)

1. Type of audit report on major program compliance
1 Unqualified opinion 2 Qualified opinion 3 Adverse opinion 4 Disclaimer of opinion
2. Does the auditor's report include a statement that the auditee's financial statements include departments, agencies, or other organizational units expending greater than \$300,000 in Federal awards that have separate A-133 audits which are not included in this audit? (AICPA SOP 98-3 chapter 10) 1 Yes 2 No
3. What is the dollar threshold to distinguish Type A and Type B programs? (\$ __.520(b)) \$ 513,593
4. Did the auditee qualify as a low-risk auditee? (\$ __.530) 1 Yes 2 No
5. Is a reportable condition disclosed for any major program? (\$ __.510(a)(1)) 1 Yes 2 No - SKIP to Item 7
6. Is any reportable condition reported as a material weakness? (\$ __.510(a)(1)) 1 Yes 2 No
7. Are any known questioned costs reported? (\$ __.510(a)(3) or (4)) 1 Yes 2 No
8. Was a Summary Schedule of Prior Audit Findings prepared? (\$ __.315(b)) 1 Yes 2 No

9. Indicate which Federal agency(ies) have current year audit findings related to direct funding or prior audit findings shown in the Summary Schedule of Prior Audit Findings related to direct funding. (Mark (X) all that apply or None)
- | | | | |
|--|--|---|--|
| 02 <input type="checkbox"/> Agency for International Development | 83 <input type="checkbox"/> Federal Emergency Management Agency | 43 <input type="checkbox"/> National Aeronautics and Space Administration | 96 <input type="checkbox"/> Social Security Administration |
| 10 <input checked="" type="checkbox"/> Agriculture | 39 <input type="checkbox"/> General Services Administration | 89 <input type="checkbox"/> National Archives and Records Administration | 19 <input type="checkbox"/> State |
| 23 <input type="checkbox"/> Appalachian Regional Commission | 93 <input checked="" type="checkbox"/> Health and Human Services | 05 <input type="checkbox"/> National Endowment for the Arts | 20 <input type="checkbox"/> Transportation |
| 11 <input type="checkbox"/> Commerce | 14 <input checked="" type="checkbox"/> Housing and Urban Development | 06 <input type="checkbox"/> National Endowment for the Humanities | 21 <input type="checkbox"/> Treasury |
| 94 <input type="checkbox"/> Corporation for National and Community Service | 03 <input type="checkbox"/> Institute for Museum Services | 47 <input type="checkbox"/> National Science Foundation | 82 <input type="checkbox"/> United States Information Agency |
| 12 <input type="checkbox"/> Defense | 15 <input type="checkbox"/> Interior | 07 <input type="checkbox"/> Office of National Drug Control Policy | 64 <input type="checkbox"/> Veterans Affairs |
| 84 <input type="checkbox"/> Education | 16 <input type="checkbox"/> Justice | 59 <input type="checkbox"/> Small Business Administration | 00 <input type="checkbox"/> None |
| 81 <input type="checkbox"/> Energy | 17 <input type="checkbox"/> Labor | | <input type="checkbox"/> Other - Specify: |
| 66 <input type="checkbox"/> Environmental Protection Agency | 09 <input type="checkbox"/> Legal Services Corp | | |

Each agency identified is required to receive a copy of the reporting package.

In addition, one copy each of the reporting package is required for:

- the Federal Audit Clearinghouse archives
- and, if not marked above, the cognizant agency (if identified in Part I, Item 9)

Count total number of boxes marked above and submit this number of reporting packages

PART III FEDERAL PROGRAMS - Continued (Page 3 - #1 of 2)

10. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR

11. AUDIT FINDINGS

| CFDA Number (a) | | | Research and development (b) | Name of Federal program (c) | Amount expended (d) | Direct award (e) | Major program (f) | Type(s) of compliance requirement(s) ³ (g) | Audit finding reference number(s) ⁴ (h) |
|--------------------------------------|------------------------|------|--|---|---------------------|---|--|---|--|
| Federal Agency Prefix ¹ | Extension ² | | | | | | | | |
| 1 | 0 | .766 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | COMMUNITY FACILITIES LOANS AND GRANTS | \$ 1,050,771 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | O | N/A |
| 1 | 0 | .588 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | CHILD CARE FOOD PROGRAM | \$ 301,766 .00 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| 1 | 0 | .570 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | NUTRITION PROGRAM FOR THE ERDERLY | \$ 9,353 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| 1 | 6 | .579 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | BYRNE FORMULA GRANT | \$ 14,736 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| 1 | 6 | .592 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | LAW ENFORCEMENT BLOCK GRANT | \$ 125,932 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| 9 | 3 | .600 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | HEAD START AND EARLY HEAD START | \$ 5,009,105 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | FC | 2003-3, 2003-5 |
| 9 | 3 | .045 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | ELDERLY COMMISSION-SPECIAL PROGRAM FOR AGING (TITLE III PART B) | \$ 108,293 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| 9 | 3 | .575 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | CHILD CARE BLOCK GRANT | \$ 684,052 .00 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | F | 2003-3 |
| 1 | 4 | .218 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | COMMUNITY DEVELOPMENT BLOCK GRANT | \$ 5,137,360 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | F | 2003-3 |
| 1 | 4 | .231 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | EMERGENCY SHELTER GRANT | \$ 246,358 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| TOTAL FEDERAL AWARDS EXPENDED | | | | | \$ 17,119,760 .00 | IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS | | | |

¹ See Appendix 1 of instructions for valid Federal Agency two-digit prefixes.

² Or other identifying number when the Catalog of Federal Domestic Assistance (CFDA) number is not available. (See Instructions)

³ Enter the letter(s) of all type(s) of compliance requirement(s) that apply to audit findings (i.e., noncompliance, reportable conditions (including material weaknesses), questioned costs, fraud, and other items reported under § .510(a)) reported for each Federal program.

- | | | | |
|------------------------------------|---|--|----------|
| A. Activities allowed or unallowed | F. Equipment and real property management | K. Real property acquisition and relocation assistance | O. None |
| B. Allowable costs/cost principles | G. Matching, level of effort, earmarking | L. Reporting | P. Other |
| C. Cash management | H. Period of availability of Federal funds | M. Subrecipient monitoring | |
| D. Davis - Bacon Act | I. Procurement and suspension and debarment | N. Special tests and provisions | |
| E. Eligibility | J. Program income | | |

⁴ N/A for NONE

PART III FEDERAL PROGRAMS - Continued (Page 3 - #2 of 2)

10. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR

11. AUDIT FINDINGS

| CFDA Number (a) | | Research and development (b) | Name of Federal program (c) | Amount expended (d) | Direct award (e) | Major program (f) | Type(s) of compliance requirement(s) ³ (a) | Audit finding reference number(s) ⁴ (b) |
|--|------------------------|--|---|---------------------|---|--|---|--|
| Federal Agency Prefix ¹ | Extension ² | | | | | | | |
| 1 | 4 .239 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | HOME INVESTMENT PARTNERSHIP PROGRAM | \$ 917,909 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | F | 2003-3 |
| 1 | 4 .871 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | SECTION 8 HOUSING CHOICE VOUCHERS | \$ 3,382,484 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | N | 2003-4 |
| 1 | 4 .241 | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | HOUSING OPPORTUNITIES FOR PERSONS WITH AIDS | \$ 131,641 .00 | 1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No | O | N/A |
| | | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | \$.00 | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | |
| | | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | \$.00 | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | |
| | | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | \$.00 | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | |
| | | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | \$.00 | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | |
| | | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | \$.00 | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | |
| | | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | \$.00 | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | 1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No | | |
| TOTAL FEDERAL AWARDS EXPENDED → | | | | \$ 17,119,760 .00 | IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS | | | |

¹ See Appendix 1 of instructions for valid Federal Agency two-digit prefixes.

² Or other identifying number when the Catalog of Federal Domestic Assistance (CFDA) number is not available. (See Instructions)

³ Enter the letter(s) of all type(s) of compliance requirement(s) that apply to audit findings (i.e., noncompliance, reportable conditions (including material weaknesses), questioned costs, fraud, and other items reported under § 5 .510(a)) reported for each Federal program.

- A. Activities allowed or unallowed
- B. Allowable costs/cost principles
- C. Cash management
- D. Davis - Bacon Act
- E. Eligibility

- F. Equipment and real property management
- G. Matching, level of effort, earmarking
- H. Period of availability of Federal funds
- I. Procurement and suspension and debarment
- J. Program income

- K. Real property acquisition and relocation assistance
- L. Reporting
- M. Subrecipient monitoring
- N. Special tests and provisions
- O. None
- P. Other

⁴ N/A for NONE

PART I Item 5 Continuation Sheet

c. List the multiple Employer Identification Numbers (EINs) covered in this report.

| | | | | | |
|----|-----|----|----|----|----|
| 1 | N/A | 16 | 31 | 46 | 61 |
| 2 | | 17 | 32 | 47 | 62 |
| 3 | | 18 | 33 | 48 | 63 |
| 4 | | 19 | 34 | 49 | 64 |
| 5 | | 20 | 35 | 50 | 65 |
| 6 | | 21 | 36 | 51 | 66 |
| 7 | | 22 | 37 | 52 | 67 |
| 8 | | 23 | 38 | 53 | 68 |
| 9 | | 24 | 39 | 54 | 69 |
| 10 | | 25 | 40 | 55 | 70 |
| 11 | | 26 | 41 | 56 | 71 |
| 12 | | 27 | 42 | 57 | 72 |
| 13 | | 28 | 43 | 58 | 73 |
| 14 | | 29 | 44 | 59 | 74 |
| 15 | | 30 | 45 | 60 | 75 |

IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS.

Municipality of Carolina
 Financial Statement Findings
 Single Audit for the year ended June 30, 2003
Corrective Action Plan

| Finding | Management Response | Corrective Action Plan |
|--|--|--|
| <p>Section 2- Financial Statement Finding</p> <p>Finding No. 2003-1</p> <p>At June 30,2003 the balances of inter-fund receivables, payables, deferred revenues, and fund balance in the SAP System were not reconciled with their subsidiaries. Puerto Rico Municipality Law (Law 81), Article 8.010, establishes that the municipalities should maintain an accounting system that is in accordance with general accepted accounting principles.</p> | <p>For the year 2002-03, the difference between the inter-funds accounts and the Sap system occurred because the process of compensating those accounts was not completed. For the purpose of preparing the Financial Statements those transaction were register on the books manually using as a base the bank transaction.</p> | <p>Instructions were given to the Supervisor of the accounting area to verified and reconciled all the inter-funds accounts. For this purpose we prepared a formulary for the requesting of banks transference. This document will allowed us to follow up the transaction until its completion. Also, we will established a monthly evaluation process to verify balance on those accounts.</p> |
| <p>Finding 2003-2</p> <p>The Subsidiary of personal property maintained in the Property Area at June 30, 2003, was not reconciled with the data per physical inventory. Puerto Rico Municipality Law (Law 81), Article 8.010, establishes that the municipalities should maintain an accounting system that is in accordance with general accepted accounting principles. Also, the Chapter VII, section 20 of the Ruling, establishes that the property transfers must be approved by the employee in charge of the property.....</p> | <p>A physical inventory is in process by the Property Director. Information obtained from the physical inventory should be compared with the subsidiary of property on computerize accounting system. If difference result these should be documented and adjusted.</p> | <p>The results obtained from the physical inventory taken will be reconciled with the subsidiary of property on computerize accounting system. Any difference noted will be investigated and corresponding adjustment will be made. In addition, we will ensure proper supervision for accounting record on equipment and we will performed a formal training program for the Property personnel in the Department of Finance to ensure adequate procedures.</p> |

Municipality of Carolina
 Financial Statement Findings
 Single Audit for the year ended June 30, 2003
Corrective Action Plan

| Finding | Management Response | Corrective Action Plan |
|---|---|---|
| <p>Section 3- Federal Awards Findings Finding 2003-3 The subsidiary of personal property maintained in the Property Area at June 30, 2003, was not reconciled with the data per physical inventory. During our inspection of certain properties, we could not satisfy ourselves about the physical location of such properties. Compliance Supplement of Circular A-133, Part 3, section F (Equipment and Property Management) establishes that the local governments shall follows the A-102 Common Rule for equipment acquired with federal awards.</p> | <p>The Property Director is in the process of taken a physical inventory. Once concluded it will be compared with the accounting system. If difference result these should be documented and adjusted.</p> | <p>We will reconciled with the subsidiary of property on computerize accounting system the result obtained from the physical inventory. Also, we will ensure proper supervision for accounting record on equipment and performed a formal training program for the Property personnel to ensure adequate procedures.</p> |
| <p>Finding 2003-4 The housing rental contracts are not signed by all the parties involved in the process of housing rental subsidy..... OMB Circular A-102, Subpart C, Post award requirements, paragraph .20-6 Standards for financial management systems-Source documentation, establishes that accounting records must be supported by such source documentation as canceled checks, paid bills, payroll....., etc.</p> | <p>The Department of Housing of the Municipality of Carolina grants rent subsidy to participant through Federal Funds granted. The qualifying process requires that participants and owners visit our office in numerous occasions. To guarantee the compliance with the responsibilities and obligations, by both part, they are required to sign an agreement. To strengthen the process of preparation, signature and registration of the contracts we recruited personal on December 1, 2002, to work with the contract process. Auditor of P. K. F. were able to verify that the situation was corrected from that date forward.</p> | <p>Re-exam appointments have been rearranged three months in advance to the effective date. Caseworkers will collect participant's signature on the contract at time of re-exam. We will contact the owner by phone call to set appointment for signature process. We will request a review of the contract registration process in order to see if we can find a feasible way to accelerate it.</p> |

Municipality of Carolina
 Financial Statement Findings
 Single Audit for the year ended June 30, 2003

Corrective Action Plan

| Finding | Management Response | Corrective Action Plan |
|--|--|--|
| <p>Finding 2003-5</p> <p>During fiscal year ended June 30,2003, the Municipality did not minimize the timing between federal cash remittances and their corresponding disbursement to meet their immediate cash needs.....</p> <p>The Common Rule, Subpart A .20(7) establishes that procedures for minimizing the elapsing between the transfer of funds and the disbursement</p> | <p>Document will be pre- intervened before requesting the funds for payment.</p> | <p>Instructions were given to Supervisor of the accounting area to pre-intervene all the documentation before requesting funds to minimize the timing between federal cash remittances and their corresponding disbursement.</p> |