

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

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

1/12/05

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2004**

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

PART I - FINANCIAL SECTION

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MUNICIPALITY OF CATAÑO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zuñiga
CPA Luis O. Rivera Zuñiga

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Cataño, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the 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.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2004 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the Municipality. The schedule of expenditures of federal awards 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.

San Juan, Puerto Rico
December 22, 2004

Ortiz, Rodriguez, Rivera & Co.

The stamp 2000989 was affixed
to the original of this report.



MANAGEMENT'S DISCUSSION AND ANALYSIS

The Municipality of Cataño (the "Municipality") discussion and analysis has been designed with the followings goals:

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

Since the Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality net assets decreased by \$3,381,482.
- Fund balance of general fund decreased by \$2,958,619
- Increase in Municipal License Tax revenue amounting to \$1,147,288.
- Capital expenditures amounted to \$3,507,301.

USING THIS ANNUAL REPORT

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

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Assets presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both of the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Infrastructure Assets

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

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's net assets totaled \$106.7 million at the end of 2004, compared to \$110.0 million at the end of the previous year.

The largest portion of the Municipality's net assets consists of the investment made throughout the years in capital assets such as land, buildings, equipment and infrastructure. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although, the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represents another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

Municipality of Cataño
Condensed Statement of Net Assets
June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Current assets	\$ 72,625,533	\$ 76,532,190
Capital assets	<u>108,073,294</u>	<u>108,337,528</u>
Total assets	<u>180,698,827</u>	<u>184,869,718</u>
Current liabilities	17,236,539	16,968,591
Noncurrent liabilities	<u>56,842,586</u>	<u>57,899,943</u>
Total liabilities	<u>74,079,125</u>	<u>74,868,534</u>
Invested in capital assets, net of related debt	83,537,846	32,454,981
Restricted	16,506,633	37,267,642
Unrestricted	<u>6,575,223</u>	<u>40,278,561</u>
Total net assets	<u>\$ 106,619,702</u>	<u>\$ 110,001,184</u>

Changes in Net Assets

The Municipality's net assets increased by \$151,401. Approximately 71 percent of the Municipality's total revenue came from taxes while 16 percent resulted from grants and contributions, including federal aid. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works and health and welfare.

Municipality of Cataño
Condensed Statement of Activities
June 30, 2004

Program revenues		
Charges for services	\$ 399,138	\$ 465,328
Operating grants and contributions	498,133	1,299,055
Capital grants and contributions	1,858,556	-
General revenues		
Property taxes	19,827,902	20,932,595
Municipal license tax	11,006,945	9,859,657
Grants and contributions not restricted to specific programs	7,561,938	7,838,074
Interest, fines and penalties	1,155,693	1,327,672
Miscellaneous	1,084,010	7,142,223
Total revenues	<u>43,392,315</u>	<u>48,864,604</u>
Expenses		
General government	19,427,709	19,982,703
Public safety	4,011,384	3,524,603
Public works	9,612,170	7,145,041
Culture and recreation	3,297,407	2,929,271
Health and welfare	6,460,572	7,996,437
Education	715,578	677,495
Interest on long-term debt	3,132,847	3,110,774
Total expenses	<u>46,657,668</u>	<u>45,366,324</u>
Change in net assets	(3,265,353)	3,498,280
Net assets, beginning of year	<u>110,001,184</u>	<u>106,502,904</u>
Net assets, end of year	<u>\$ 106,735,831</u>	<u>\$ 110,001,184</u>

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$55.4 million, a decrease of \$4.2 million in comparison with the prior year. There are reservations of fund balance amounting to \$36.4 million. This is the fund balance that is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$.4 million) and 2) to pay debt service (\$16.5 million) and 3) to pay for capital projects (\$19.5 million).

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has a balance of \$19.4 million. The fund balance decreased by \$3.0 million during fiscal year 2004.

The key factor in the decrease of the fund balance of the general fund was higher than expected general government expenditures which were mainly caused by the change in the management of the Municipality.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget to reclassify certain expenditures among the different governmental functions. Such reclassifications were necessary to provide for the developments that affected the Municipality's finances. Also, during fiscal year 2003-2004 the budget was amended twice in order to increase the expenditures of the Municipality using the unrestricted fund balance. The first increase was approved on November 13, 2003 for the amount of \$5,894,300. The second increase was approved on February 25, 2004 for the amount of \$3,800,000. The expenditures that were significantly increased included professional services, maintenance of buildings and equipment, waste disposal, non-professional services, capital projects and miscellaneous among others.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$127.1 million, net of accumulated depreciation of \$19.1 million, leaving a net book value of \$108.0 million. This investment in capital assets includes land, buildings, improvements, equipment, intangibles, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the Municipality's investment in capital assets for the current fiscal year was about 0.1% in terms of net book value. Actual expenditures to purchase or construct capital assets were \$3.5 million for the year. Depreciation charges for the year totaled \$3.8 million.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2004 the Municipality has \$19.5 million of unexpended proceeds from bond issuances that are committed to future construction activities.

Debt Administration

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

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

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2004-2005 fiscal year.

The most significant change between the budget for fiscal year 2003-2004 and the one for fiscal year 2004-2005 are the following:

- a) Increase in Municipal License Tax revenue of \$1,845,956
- b) Increase in Licenses and Permits revenue of \$1,335,000
- c) Increase in Other revenues of \$2,773,631
- d) Increase in General Government expenditures of \$7,249,282

The increase in Municipal License Tax and License and Permits revenues is expected mainly due to increased economic activity due to capital projects being carried out by the central government and the Municipality. Also, the Municipality expects to collect previous year's taxpayer debts that has been identified by ongoing collection efforts.

The increase in Other revenues is expected due to overpayments made to ASES during previous fiscal years which are to be refunded during fiscal year 2005-2005.

Increase in General Government expenditures of \$7,249,282 is due to increases to employee's salaries, increased cost of the medical plan and the establishment of a summer bonus.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 4th floor of the Town Hall, Cataño, Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
STATEMENT OF NET ASSETS
JUNE 30, 2004**

<u>Assets</u>	<u>Governmental Activities</u>
Cash and cash equivalents (Note 2)	\$ 31,821,506
Cash with fiscal agent (Note 2)	38,869,477
Interest receivable	64,148
Due from other agencies (Note 8)	1,870,402
Capital assets, net (Note 10)	<u>108,073,294</u>
 Total assets	 <u>\$ 180,698,827</u>
 <u>Liabilities and Net Assets</u>	
Liabilities	
Account payable and accrued liabilities	\$ 3,030,333
Due to other agencies (Note 11)	1,748,810
Matured bonds and interest payable	3,709,147
Deferred revenues (Note 12):	
Municipal license tax	8,584,702
Federal government	163,547
Noncurrent liabilities (Note 14):	
Due within one year	2,553,941
Due in more than one year	54,288,645
Total liabilities	<u>74,079,125</u>
 Net Assets	
Investment in capital assets, net of related debt	64,053,294
Restricted for:	
Debt service	16,506,633
Capital projects	19,484,552
Unrestricted	6,575,223
Total net assets	<u>106,619,702</u>
 Total liabilities and net assets	 <u>\$ 180,698,827</u>

The accompanying notes are an integral part of these basic financial statements.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense)</u>
		<u>Charges for Services</u>	<u>Capital Grants and Contributions</u>	<u>Operating Grants and Contributions</u>	<u>Revenue and Changes in Net Assets</u>
					<u>Primary Government Governmental Activities</u>
Primary Government:					
General government	\$ 19,427,709	\$ 399,138	\$ 1,436,214	\$ -	\$ (17,592,357)
Public safety	4,011,385		290,588		(3,720,797)
Public works	9,728,299		131,754		(9,596,545)
Culture and recreation	3,297,407			498,133	(2,799,274)
Health and welfare	6,460,572				(6,460,572)
Education	715,578				(715,578)
Interest on long-term debt	3,132,847				(3,132,847)
Total	<u>\$ 46,773,797</u>	<u>\$ 399,138</u>	<u>\$ 1,858,556</u>	<u>\$ 498,133</u>	<u>(44,017,970)</u>
General revenues:					
Property taxes					19,827,902
Municipal license tax					11,006,945
Grants and contributions not restricted to specific programs					7,561,938
Interest, fines and penalties					1,155,693
Miscellaneous					1,084,010
Total general revenues					<u>40,636,488</u>
Change in net assets					(3,381,482)
Net assets at beginning of year					<u>110,001,184</u>
Net assets at end of year					<u>\$ 106,619,702</u>

The accompanying notes are an integral part of these basic financial statements.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Assets</u>	<u>General</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Note 2)	\$ 30,650,756	\$ -	\$ 1,002,808	\$ 167,942	\$ 31,821,506
Cash with fiscal agent (Note 2)	9,620	20,215,780	18,552,430	91,647	38,869,477
Interest receivable	64,148				64,148
Due from other agencies (Note 8)	1,723,104			147,298	1,870,402
Total assets	\$ 32,447,628	\$ 20,215,780	\$ 19,555,238	\$ 406,887	\$ 72,625,533

The accompanying notes are an integral part of these basic financial statements.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities					
Account payable and accrued liabilities	\$ 2,734,257	\$ -	\$ 70,686	\$ 225,390	\$ 3,030,333
Due to other agencies (Note 11)	1,730,860			17,950	1,748,810
General obligations: (Note 14)					
Bonds		1,913,867			1,913,867
Interest		1,795,280			1,795,280
Deferred revenues: (Note 12)					
Municipal license tax	8,584,702				8,584,702
Federal government				163,547	163,547
Total liabilities	<u>13,049,819</u>	<u>3,709,147</u>	<u>70,686</u>	<u>406,887</u>	<u>17,236,539</u>
Fund Balances					
Reserved for:					
Encumbrances	417,961				417,961
Debt service		16,506,633			16,506,633
Capital projects			19,484,552		19,484,552
Unreserved fund balance	18,979,848				18,979,848
Total fund balance	<u>19,397,809</u>	<u>16,506,633</u>	<u>19,484,552</u>	<u>-</u>	<u>55,388,994</u>
Total liabilities and fund balance	<u>\$32,447,628</u>	<u>\$20,215,780</u>	<u>\$19,555,238</u>	<u>\$ 406,887</u>	<u>\$ 72,625,533</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2004**

Total fund balances - governmental funds	\$ 55,388,994
Amounts reported for governmental activities in the statement of net assets are different because:	
• Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet	108,073,294
• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. (Note 4)	<u>(56,842,586)</u>
Net assets of governmental activities	<u>\$ 106,619,702</u>

The accompanying notes are an integral part of these basic financial statements.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES-GOVERNMENTAL FUNDS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
REVENUES					
Property taxes (Note 6)	\$ 14,902,268	\$ 4,925,634	\$ -	\$ -	\$ 19,827,902
Municipal license taxes (Note 7)	11,006,945				11,006,945
Licenses and permits	1,526,566				1,526,566
Charges for service and rents	399,138				399,138
Intergovernmental revenues: (Note 13)					
Federal grants and contributions				1,921,240	1,921,240
State contributions	4,612,265		1,858,556		6,470,821
Interest, fines, and penalties	992,805	162,888			1,155,693
Other revenues	1,084,010				1,084,010
Total revenues	<u>34,523,997</u>	<u>5,088,522</u>	<u>1,858,556</u>	<u>1,921,240</u>	<u>43,392,315</u>
EXPENDITURES					
General government	16,241,885				16,241,885
Public safety	3,797,059				3,797,059
Public works	8,734,046			549,585	9,283,631
Culture and recreation	2,838,779				2,838,779
Health and welfare	5,429,270			873,522	6,302,792
Education	609,229				609,229
Capital outlays			3,009,168	498,133	3,507,301
Debt service:					
Principal retirement		1,913,868			1,913,868
Interest and other		3,132,847			3,132,847
Total expenditures	<u>37,650,268</u>	<u>5,046,715</u>	<u>3,009,168</u>	<u>1,921,240</u>	<u>47,627,391</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(3,126,271)</u>	<u>41,807</u>	<u>(1,150,612)</u>	<u>-</u>	<u>(4,235,076)</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	167,652				167,652
Transfers out	-	(167,652)	-		(167,652)
Total other financing sources (uses)	<u>167,652</u>	<u>(167,652)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Deficiency of revenues and other sources over expenditures and other uses	<u>(2,958,619)</u>	<u>(125,845)</u>	<u>(1,150,612)</u>	<u>-</u>	<u>(4,235,076)</u>
FUND BALANCE AT BEGINNING OF YEAR	<u>22,356,428</u>	<u>16,632,478</u>	<u>20,635,164</u>		<u>59,624,070</u>
FUND BALANCE AT END OF YEAR	<u>\$ 19,397,809</u>	<u>\$ 16,506,633</u>	<u>\$ 19,484,552</u>	<u>\$ -</u>	<u>\$ 55,388,994</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Net change in fund balances - total governmental funds \$(4,235,076)

Amounts reported for governmental activities 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 and reported as depreciation expense. 3,507,301
- Depreciation expense on capital assets is reported in the statement of activities, but do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (3,771,535)
- Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 2,762,677
- Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds. (1,644,849)

Changes in net assets of governmental activities \$(3,381,482)

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL-GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund				Debt Service Fund			
	Budgeted Amounts		Actual	Variance with Final Budget-Positive (Negative)	Budgeted Amounts		Actual	Variance with Final Budget-Positive (Negative)
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 14,161,585	\$ 14,161,585	\$ 14,821,388	\$ 659,803	\$ 4,322,993	\$ 4,322,993	\$ 4,925,634	\$ 602,641
Municipal license taxes	10,039,547	10,039,547	11,006,945	967,398				
Licenses and permits	601,000	601,000	1,526,566	925,566				
Charges for services and rent	330,000	330,000	399,138	69,138				
Intergovernmental revenues:								
State contributions	4,383,324	4,383,324	4,612,265	228,941			162,888	162,888
Interest, fines and penalties	1,506,000	1,506,000	1,160,457	(345,543)				
Other revenues	31,500	31,500	1,084,010	1,052,510				
Total revenues	31,052,956	31,052,956	34,610,769	3,557,813	4,322,993	4,322,993	5,088,522	765,529
EXPENDITURES								
Current:								
General government	14,045,096	18,827,840	16,041,162	2,786,678				
Public safety	3,725,992	3,813,037	3,797,059	15,978				
Public works	4,933,378	8,890,589	8,734,046	156,543				
Culture and recreation	2,696,424	2,926,323	2,838,779	87,544				
Health and welfare	5,049,836	5,643,080	5,429,270	213,810				
Education	602,230	646,387	609,229	37,158				
Debt service:								
Principal					4,322,993	4,322,993	1,913,868	2,409,125
Interest							3,132,847	(3,132,847)
Total expenditures	31,052,956	40,747,256	37,449,545	3,297,711	4,322,993	4,322,993	5,046,715	(723,722)
OTHER FINANCING SOURCES								
Reprogramming funds		9,694,300	9,694,300	-				
Excess of revenues over expenditures	\$ -	\$ -	\$ 6,855,524	\$ 6,855,524	\$ -	\$ -	\$ 41,807	\$ 41,807

The accompanying notes are an integral part of these basic financial statements.

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. ORGANIZATION

The Municipality of Cataño, Puerto Rico (Municipality) was founded in 1927. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial information of the Municipality is presented in this report as follows:

- **Management's Discussion and Analysis** - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- **Government - Wide Financial Statements** - This reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).
- **Statement of Net Assets** - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.

- **Statement of Program Activities** - The new government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- **Budgetary comparison schedules** - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the new reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

2) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

3) Capital Project Fund

This fund is used to account for the financial resources used for the acquisition and construction of major capital facilities, financed with the proceeds of general obligation bonds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

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

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

d. Cash, Cash with Fiscal Agent and Certificates of Deposits

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts and certificates of deposit with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB). The Municipality's policy is to invest any excess cash in certificates of deposits with institutions qualified by the PRTD. Earnings from these funds are recorded in the corresponding fund.

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The Municipality considers all investments with an original maturity of three months or less to be cash equivalents.

e. Interfund Receivables and Payables

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

f. Capital Assets

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. 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 in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

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

1) 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

2) Debt Service

Represents net assets available to finance future debt service payments.

3) Capital Projects Fund

Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2004 amounted to \$488,346. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$651,150 for workers' compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

j. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board has issued the following statements that the Municipality has not yet adopted:

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
40	Deposit and Investment Risk Disclosures	2004-05
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2004-05
43	Financial Reporting for Post-employment Benefit Other than Pension Plans	2005-06
44	Economic Condition Reporting: The Statistical Section - an amendment on NCGA Statement I	2005-06
45	Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions	2009-10

The impact of these statements on the Municipality's financial statement has not yet been determined.

k. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

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

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing uses for the year ended June 30, 2004 is presented below for the general fund and debt service funds:

	<u>General Fund</u>	<u>Debt Service Fund</u>
Excess of revenues over expenditures - budgetary basis	\$6,855,524	\$ 41,807
Entity differences:		
Non-budgeted transfers-out		(167,652)
Reprogramming of funds	(9,694,300)	
Timing differences:		
Prior year encumbrances recorded as current year expenditures for GAAP basis	217,238	-
Current year encumbrances recorded as expenditures for budgetary basis	(417,961)	-
Basis of accounting differences:		
Net change in receivables	<u>80,880</u>	<u>-</u>
Deficiencies of revenues over expenditures - GAAP basis	<u>(\$2,958,619)</u>	<u>(\$125,845)</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$57 million difference are as follows:

Bonds payable	\$44,020,000
Note payable	6,916,298
Compensated absences	5,356,651
Claims and judgements	<u>549,637</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$56,842,586</u>

5. DEPOSITS

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The Municipality's bank balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2004. Risk categories are described as follows:

Category 1: Deposit is insured or collateralized with securities held by the Secretary of the Treasury's agents in the Municipality's name.

Category 2: Deposit is collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.

Category 3: Deposit is uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

The Municipality's bank balances in commercial banks of \$30,660,375 in the governmental activities were fully collateralized at June 30, 2004 (Category 1). In the capital projects fund and other governmental funds there were deposits with commercial banks of \$1,004,534 and \$279,100, respectively, that were fully collateralized.

The deposits of GDB of \$19,323,909 that are restricted principally for capital projects, and the \$20,215,780 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks (Category 3).

The Municipality maintains its deposits in four (4) banks located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.08% for real property and 6.08% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	< .20% >	< .20% >
	<u>8.08%</u>	<u>6.08%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year ends. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. During July 2002, the Municipality entered into a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001 for approximately \$7.0 million. This amount will be repaid through advances from property taxes (refer to Note 14).

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2003-04, but not the final settlement as the six months period after fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2004, the amount received in advances from CRIM exceeded the amount collected from taxpayers and charges by CRIM for the same period by \$80,880. Such amount is presented as intergovernmental receivable in the general fund in the basic financial statements. (Refer to Note 8).

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2004. The annual Municipal License Tax is determined based on the gross

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

income of all commerce and industrial organizations who have operations in the Municipality of Cataño, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of Cataño, are as follows:

Financial institutions	=	1.5%
Savings and loans associations	=	1.25%
Other organizations	=	.5%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year \$8,584,702, corresponding to the next fiscal year municipal license.

8. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power of Authority	\$1,642,224
Municipal Revenue Collection Center	80,880
Other governmental funds	<u>147,298</u>
 Total	 <u>\$1,870,402</u>

9. INTERFUND TRANSACTIONS

Interfund Transfers:

Interfund transfers for the year ended June 30, 2004 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
General	Debt Service	<u>\$167,652</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Remaining transfers are used to (1) move receipts restricted to debt service from the fund collecting the receipts to the debt service fund as debt service payments become due and (2) move revenues from the fund that statute or budget revenues to collect them to the fund that statute or budget requires to expend them.

10. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004 was as follows:

	<u>Balance July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2004</u>
Capital assets, not being depreciated:				
Land	\$ 9,156,887	\$ -	\$ -	\$ 9,156,887
Construction in progress	30,339,036	1,720,497	442,815	31,616,718
Total capital assets, not being depreciated	<u>39,495,923</u>	<u>1,720,497</u>	<u>442,815</u>	<u>40,773,605</u>
Capital assets, being depreciated:				
Buildings and building improvements	32,045,997	627,792		32,673,789
Site improvements	32,870,462	188,877		33,059,339
Intangibles	122,561	18,608		141,169
Vehicles and equipment	5,061,428	1,230,130		6,291,558
Infrastructure	14,045,469	164,212		14,209,681
Total capital assets, being depreciated	<u>84,145,917</u>	<u>2,229,619</u>	<u>-</u>	<u>86,375,536</u>
Less accumulated depreciation for:				
Buildings and building improvements	7,015,386	1,091,110		8,106,496
Site improvements	2,837,915	1,421,308		4,259,223
Intangibles	45,611	28,234		73,845
Vehicles and equipment	3,396,888	875,641		4,272,529
Infrastructure	2,008,512	355,242		2,363,754
Total accumulated depreciation	<u>15,304,312</u>	<u>3,771,535</u>	<u>-</u>	<u>19,075,847</u>
Total capital assets, being depreciated, net	<u>68,841,605</u>	<u>(1,541,916)</u>	<u>-</u>	<u>67,299,689</u>
Governmental activities capital assets, net	<u>\$ 108,337,528</u>	<u>\$ 178,581</u>	<u>\$ 442,815</u>	<u>\$ 108,073,294</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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

General government	\$2,389,784
Public safety	214,326
Public works	444,668
Culture and recreation	458,628
Health and welfare	157,780
Education	<u>106,349</u>
 Total	 <u>\$3,771,535</u>

11. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2004 are as follows:

Puerto Rico Electric Power Authority	\$1,422,992
Retirement System Administration	237,277
Puerto Rico Water and Sewer Authority	7,275
Puerto Rico Labor Department	17,950
General Services Administration	830
Municipality of Toa Baja	<u>62,486</u>
 Total	 <u>\$1,748,810</u>

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of \$8,584,702 in the general fund related to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

b. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant. These were related to various federal programs/grants, which are included within other governmental funds.

13. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

14. LONG-TERM DEBTS

Bonds and notes payable and other debt outstanding at June 30, 2004 are as follows:

Bonds

\$14,520,000 series of 1995, payable in annual installments of \$315,000 to \$1,370,000 until 2014, interest from 6.5% to 7.706%.	\$ 9,925,000
\$18,825,000 series of 1998, payable in annual installments of \$260,000 to \$1,635,000 until July 1, 2023, interest at 8%.	16,520,000
\$18,825,000 series of 1998, payable in annual installments of \$260,000 to \$1,635,000 until July 1, 2023, interest at 8%.	10,425,000
\$7,240,000 series of 2001, payable in annual installments of \$195,000 to \$715,000 until July 1, 2019, interests at 8%.	6,610,000
\$845,000 series of 2003, payable in annual installments of \$145,000 to \$190,000 until July 1, 2007, interests at 6.5%.	<u>540,000</u>
Total bonds payable	<u>\$44,020,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Note Payable

Note payable of approximately \$7.0 million represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate principal installments of \$103,920 plus an interest rate of 6.25%.

The annual debt service requirements for the bonds payable and advances from CRIM at June 30, 2004, are as follows:

	<i>Bonds</i>		<i>Note Payable</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 1,970,000	\$ 2,586,237	\$ 96,394	\$ 426,478
2006	2,125,000	2,485,835	102,451	420,421
2007	2,290,000	2,369,678	108,888	415,984
2008	2,265,000	2,240,548	117,737	407,142
2009	2,445,000	2,110,391	123,021	220,771
2010-2014	15,515,000	8,101,255	916,410	2,218,829
2015-2019	12,865,000	3,664,635	1,068,250	1,546,488
2020-2024	4,545,000	611,720	1,448,760	2,388,597
2025-2029	-	-	1,964,706	649,752
2030-2033	-	-	969,681	76,136
	<u>\$44,020,000</u>	<u>\$24,170,299</u>	<u>\$6,916,298</u>	<u>\$8,770,598</u>

As described in Note 6, the Municipality levies an annual special tax of 1.48% of the assessed value of real property. The proceeds of this tax are required to be credited to the Debt Service Fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected and retained by the CRIM.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due Within One year</u>
Governmental Activities:					
Bonds payable	\$ 45,850,000	\$ -	\$ (1,830,000)	\$ 44,020,000	\$ 1,970,000
Note payable	7,000,166		(83,868)	6,916,298	96,394
Total long-term debt	52,850,166	-	(1,913,868)	50,936,298	2,066,394
Claims and judgements	741,367	144,637	(336,367)	549,637	
Compensated absences	4,308,140	1,500,212	(451,701)	5,356,651	487,547
Total other liabilities	5,049,507	1,644,849	(788,068)	5,906,288	487,547
Total noncurrent liabilities	<u>\$ 57,899,673</u>	<u>\$ 1,644,849</u>	<u>\$ (2,701,936)</u>	<u>\$ 56,842,586</u>	<u>\$ 2,553,941</u>

15. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the ACT 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, 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 the Municipality on or after January 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2004 was \$1,191,864. The Municipality's payroll for employees covered by ERS was \$12,850,285. The Municipality total payroll for all employees was \$16,598,004.

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

16. RISK MANAGEMENT

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

17. LEASES

Leasing arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place and Transportation center under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2004 was approximately \$352,000.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

Leasing arrangements with the Municipality as lessee:

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

18. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.
- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

19. COMMITMENTS

The Municipality of Cataño had several outstanding or planned construction projects as of June 30, 2004. These projects are evidenced by contractual commitments with contractors. The construction projects of the Municipality are commitments of the Capital Projects' funds that amounts approximately \$957,800.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)		
Pass-through State - Commissioner Office of Municipal Affairs Community Development Block Grant-State Program SBGP	14.228	\$1,047,718
Subtotal U.S. Department of HUD		<u>1,047,718</u>
U.S. Department of Health and Human Services (HHS)		
Pass-through the Office of Administration for Children and Families Child Care and Development Block Grant	93.575	118,678
Community Service Block Grant	93.569	<u>1,364</u>
Subtotal U.S. Department of HHS		<u>120,042</u>
U.S. Department of Education		
Event Start-State Educational Agencies	84.213	131,511
Child and Adult Care Food Program	84.999	<u>14,508</u>
Subtotal Department of Education		<u>146,019</u>
U.S. Department of Transportation		
Public Transportation for Nonurbanized Areas	20.509	<u>6,273</u>
Subtotal U.S. Department of Transportation		<u>6,273</u>
U.S. Department of Labor		
School to Work		<u>519,507</u>
Subtotal U.S. Department of Labor	84.278	<u>519,507</u>
TOTAL		<u>\$1,839,559</u>

See notes to schedule of expenditures of federal awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Cataño and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Federal expenditures are included within the other governmental funds column in the accompanying statement of revenues, expenditures and changes in fund balances-governmental funds.



ORTIZ, RODRIGUEZ, RIVERA & CO.
CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis O. Rivera Zúñiga

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Municipality of Cataño as of and for the year ended June 30, 2004, which collectively comprise Municipality's basic financial statements and have issued our report thereon dated December 22, 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.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Cataño's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect of 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 test disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Municipality of Cataño's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide

assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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 basic 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Municipality of Cataño, in a separate letter dated December 22, 2004.

This report is intended solely for the information and use of the management, Commissioner Office of Municipal Affairs, and the 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.

Ortiz, Rodriguez, Rivera & Co.

San Juan, Puerto Rico
December 22, 2004

The stamp 2000990 was affixed
to the original of this report





ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zuñiga
CPA Luis O. Rivera Zuñiga

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH
REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

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

Compliance

We have audited the compliance of Municipality of Cataño with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. Municipality of Cataño's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Cataño's management. Our responsibility is to express an opinion on Municipality of Cataño's compliance based on our audit.

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

In our opinion, Municipality of Cataño complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 04-1 and 04-2.

Internal Control over Compliance

The management of Municipality of Cataño 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 Municipality of Cataño's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components do not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the management, Commissioner Office of Municipal Affairs, and the 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.

Ortiz, Rodriguez, Rivera & Co.

San Juan, Puerto Rico
December 22, 2004

The stamp 2000991 was affixed
to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expresses an unqualified opinion on the financial statements of the Municipality of Cataño.
- b. There were no reportable conditions on internal controls.
- c. No instances of noncompliance material to the financial statements of Municipality of Cataño were disclosed during the audit.
- d. There were reportable conditions on internal controls over major programs.
- e. The auditor's report on compliance for the major federal award programs for Municipality of Cataño express an unqualified opinion.
- f. Audit finding relation to the major federal award programs for Municipality of Cataño is reported in number 3 of this schedule.
- g. The programs tested as major programs included:
 - SBGP - CFDA No. 14.228
 - School to Work - CFDA No. 84.278
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Cataño was determined to be a low-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
SBGP CFDA No. 14.228	<p>Condition 04-1</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.20(b)(7) establishes that the federal funds recipient will adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.</p> <p><u>Cause</u></p> <p>The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.</p> <p><u>Effect</u></p> <p>The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.</p> <p><u>Recommendation</u></p> <p>The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.</p>	<p>\$ <u>-0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
<p>School to Work CFDA No. 84.278</p>	<p>Condition 04-2</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.20(b)(7) establishes that the federal funds recipient will adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.</p> <p><u>Cause</u></p> <p>The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.</p> <p><u>Effect</u></p> <p>The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.</p> <p><u>Recommendation</u></p> <p>The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.</p>	<p style="text-align: center;">\$ <u>-0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CATAÑO
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
SBGP CFDA No. 14.228	Condition 00-1 The program does not comply with the cash management requirement.	Condition still prevails.
SBGP CFDA No. 14.228	Condition 01-1 The program does not comply with the cash management requirement.	Condition still prevails.
SBGP CFDA No. 14.228	Condition 02-1 The program does not comply with the cash management requirement.	Condition still prevails.
SBGP CFDA No. 14.228	Condition 03-1 The program does not comply with the cash management requirement.	Condition still prevails.

CORRECTIVE ACTION PLAN

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562



Gobierno Municipal de Cataño

Oficina Programas Federales

P.O. Box 428

Cataño, Puerto Rico 00963

CORRECTIVE ACTION PLAN

Iris D. Caldera Rodríguez
Directora Ejecutiva

Tel. (787) 788-0404
Exts. 2537 / 2507 / 2539
Fax: (787) 788-2380

December 22, 2004

Cognizant or Oversight Agency for Audit:

Municipality of Cataño respectfully submits the following corrective action plan for the year ended June 30, 2004

Name and address of independent public accounting firm: Ortiz, Rodríguez, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2004

The findings from the June 30, 2004 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS - FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Finding 04-1: SBGP - CFDA 14.228

Reportable Condition: See Condition 04-1

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Finance Department, in coordination with the Federal Program Department, will establish procedures, in order to minimize the time into receiving and disbursing the federal funds. In addition, the Federal Program Department will establish a cash management book, in order to correct the situation.

Finding 04-2: School to Work - CFDA 84.278

Reportable Condition: See Condition 04-2

Recommendation

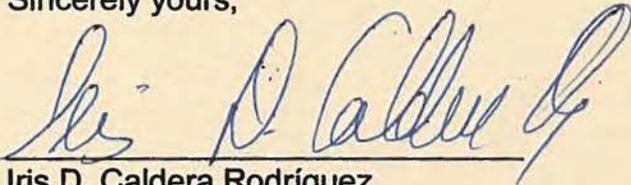
The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Finance Department, in coordination with the Federal Program Department, will establish procedures, in order to minimize the time into receiving and disbursing the federal funds. In addition, the Federal Program Department will establish a cash management book, in order to correct the situation.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Iris D. Caldera Rodríguez at (787) 788-2270.

Sincerely yours,



Iris D. Caldera Rodríguez
Federal Programs Director