

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CIALES
AUDITORIA 2003-2004

30 DE JUNIO DE 2004

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES

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

COM
MUNICIPALIDAD DE
CIALES
05 MAR 31 PM 3:45

9566-507/Am
Call 1165-9736

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, P.O. Box 70750, San Juan, PR 00936-7050 • Phone (787) 756-8524 Fax (787) 271-0523

02
47-05
K

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

TABLE OF CONTENTS

	<u>Pages</u>
PART I - FINANCIAL SECTION	
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-10
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets	11
Statement of Activities	12
Fund Financial Statements-Governmental Funds	
Balance Sheet	13-14
Reconciliation of the Governmental Funds Balance Sheet to Statement of Net Assets	15
Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)	16
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities ...	17
Statement of Revenues and Expenditures - Budget and Actual - General and Debt Service Funds	18
Notes to Basic Financial Statements	19-48

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152 P.O. Box 70250 San Juan, P.R. 00936-7250 • Phone (787) 756-8504 Fax (787) 374-0560

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

TABLE OF CONTENTS (CONTINUED)

	<u>Pages</u>
PART II – SINGLE AUDIT SECTION	
Schedule of Expenditures of Federal Awards	49
Notes to Schedule of Expenditures of Federal Awards	50
Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	51-52
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	53-54
Schedule of Findings and Questioned Costs	55-56
Schedule of Status of Prior Year Audit Findings and Questioned Costs	57-58
PART III – CORRECTIVE ACTION PLAN	
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



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

To the Honorable Mayor and
Municipal Legislature
Municipality of Ciales
Ciales, 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 Ciales, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Colinas de Jaguas Project, as of June 30, 2004. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Colinas de Jaguas Project, is based on the report of the other auditors.

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

The Municipality does not reconcile cash accounts balances of the General and Capital Projects Funds. Therefore, we do not express an opinion on such amount presented in those funds.

Based on our audit and the report of other auditors, except for the reconciliation of cash accounts balances of the General and Capital Projects Funds, the financial statements referred to above present fairly, in all material respects, the respective financial position

of the governmental activities, the discretely presented component unit, each major fund and the aggregate remaining fund information of the Municipality of Ciales 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 a report dated December 15, 2004 on our consideration of the Municipality's internal control over financial reporting and 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 10 is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires 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. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

San Juan, Puerto Rico
December 15, 2004

Ortiz, Rodriguez, Rivera & Co.

The stamp 2000971 was affixed
to the original of this report.



MANAGEMENT'S DISCUSSION AND ANALYSIS

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

- Assist the reader in focusing on significant financial issues,
- Provide an overview of the Municipality's financial activity,
- Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- Identify any material deviations from the financial plan (the approved budget), and;
- 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 increased by \$151,401.
- In the fund financial statements, general fund revenues increased \$503,609 (or 7.13%).
- Housing and Urban Development Programs revenues increased by \$188,363 (or 14.34%).
- Capital expenditures amounted to \$1,135,072.

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 \$10.948 million at the end of 2004, compared to \$10.796 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.

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

Current assets increased by \$414,626 from the year 2003, mainly due to an increase in cash in bank amounting to \$336,610. Capital assets increased by \$421,340 due to capital expenditures amounting to \$1,135,072 offsetted by depreciation of \$713,732.

Condensed Statement of Net Assets
June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Current assets	\$ 4,164,271	\$ 3,749,645
Capital assets	15,152,923	14,731,583
Total assets	<u>19,317,194</u>	<u>18,481,228</u>
Current liabilities	3,882,727	3,290,593
Noncurrent liabilities	4,486,717	4,394,286
Total liabilities	<u>8,369,444</u>	<u>7,684,879</u>
Invested in capital assets, net of related debt	14,924,155	14,243,737
Restricted	2,497,498	2,414,108
Unrestricted	(6,473,903)	(5,861,496)
Total net assets	<u>\$ 10,947,750</u>	<u>\$ 10,796,349</u>

Changes in Net Assets

The Municipality's net assets increased by \$151,401. Approximately 67 percent of the Municipality's total revenue came from grants and contributions, including federal aid, while 16 percent resulted from taxes. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works and health and welfare.

Condensed Statement of Activities
June 30, 2004

Program revenues		
Charges for services	\$ 454,466	\$ 533,402
Operating grants and contributions	1,308,545	1,170,894
Capital grants and contributions	1,088,005	901,691
General revenues		
Property taxes	1,157,340	1,174,012
Municipal license tax	562,926	540,253
Grants and contributions not restricted to specific programs	4,766,213	4,406,332
Interest and investment earnings	25,428	-
Miscellaneous	1,285,556	891,857
	<u>10,648,479</u>	<u>9,618,441</u>
Expenses		
General government	4,482,423	4,029,205
Public safety	831,172	713,651
Public works	2,593,347	2,619,261
Culture and recreation	403,454	368,923
Health and welfare	1,993,947	1,754,286
Education	45,269	-
Interest on long-term debt	147,466	156,680
	<u>10,497,078</u>	<u>9,642,006</u>
Change in net assets	151,401	(23,565)
Net assets, beginning of year	<u>10,796,349</u>	<u>10,819,914</u>
Net assets, end of year	<u>\$ 10,947,750</u>	<u>\$ 10,796,349</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 \$281,544, a decrease of \$334,188 in comparison with the prior year. There are reservations of fund balance amounting to \$2,546,068. 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 (\$43,341) and 2) to pay debt service (\$134,555) and 3) to pay for capital projects (\$2,368,172).

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 deficit of \$2,221,183. The deficit increased by \$339,653 during fiscal year 2004.

The key factor in the increase of the deficit in the general fund was an increase in the accrual of claims and judgments amounting to \$275,000 for a pending claim against the Municipality; there is a substantial probability that the outcome of the litigation will be unfavorable to 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.

The most significant variance between budget and actual results was a revenue shortfall on Licenses, permits and other local taxes and Charges for services offsetted by excess Intergovernmental and Other revenues when compared to budget.

The reason for the shortfall in Licenses, permits and other local taxes was due to the delay of major construction projects in the Municipality which are being undertaken by the government of the Commonwealth of Puerto Rico. The shortfall in actual revenues in the charges for services was due to the fact that the Municipality had planned to charge its constituents for garbage disposal but it was not done. Excess Intergovernmental, Other revenues, and Other financing sources were the result of a settlement with the Puerto Rico Electric Power Authority ("PREPA") amounting to \$412,851,

issuance of debt amounting to \$250,000 and additional grants received from the Commonwealth of Puerto Rico amounting to approximately \$545,000.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$20.3 million, net of accumulated depreciation of \$5.2 million, leaving a net book value of \$15.1 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 2.9% in terms of net book value. Actual expenditures to purchase or construct capital assets were \$1.1 million for the year. Depreciation charges for the year totaled \$.7 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 \$2.4 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 2003-2004 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:

- The amount budgeted for Excise Tax on construction projects within the Municipality increased by \$832,632. The increase is due to significant projects under construction or planned to begin construction during fiscal year 2005.
- The amount budgeted for general government expenditures increased by \$835,284. This increase is a reflection of the increase expected in Excise Taxes on constructions projects as explained above.

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 1st floor of the Town Hall, Ciales, Puerto Rico 00638.

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

<u>Assets</u>	<u>Governmental Activities</u>	<u>Colinas de Jaguas</u>
Cash in bank (Note 2)	\$ 2,287,200	\$ -
Cash with fiscal agent (Note 2)	328,775	
Accounts receivables:		
Other		6,044
Due from other agencies (Note 8)	1,548,296	
Restricted deposits		112,075
Other assets		17,399
Capital assets, net (Note 10)	15,152,923	925,487
	<hr/>	<hr/>
Total assets	\$ 19,317,194	\$ 1,061,005
	<hr/>	<hr/>
<u>Liabilities and Net Assets</u>		
Liabilities		
Bank overdraft	\$ -	\$ 1,245
Account payable and accrued liabilities	1,157,506	53,560
Due to other agencies (Note 11)	1,139,940	
Matured bonds and interest payable	188,991	
Deferred revenues (Note 12):		
Municipal license tax	490,947	
Federal government	430,343	
Claims and judgements	475,000	
Noncurrent liabilities (Note 14):		
Due within one year	687,543	14,291
Due in more than one year	3,799,174	1,620,622
Total liabilities	8,369,444	1,689,718
	<hr/>	<hr/>
Net Assets		
Investment in capital assets, net of related debt	14,924,155	
Restricted for:		
Debt service	134,555	
Capital project	2,362,943	
Unrestricted	(6,473,903)	(628,713)
Total net assets	10,947,750	(628,713)
	<hr/>	<hr/>
Total liabilities and net assets	\$ 19,317,194	\$ 1,061,005
	<hr/>	<hr/>

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

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

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary	Component
					Governmental Activities	Unit Colinas de Jaguas Project
Primary Government:						
General government	\$ 4,482,423	\$ 454,466	\$ -	\$ -	\$ -	
Public safety	831,172			(831,172)		
Public works	2,593,347			1,088,005		
Recreation	403,454			(403,454)		
Health and welfare	1,993,947		1,308,545	(685,402)		
Education	45,269			(45,269)		
Interest on long term debt	147,466			(147,466)		
Total primary government	\$ 10,497,078	\$ 454,466	\$ 1,308,545	\$ 1,088,005	\$ (7,646,062)	
Component Unit:						
Colinas de Jaguas Project	\$ 388,857	\$ 282,801	\$ -	\$ -	(106,056)	
General revenues:						
Property taxes				1,157,340		
Municipal license tax				562,926		
Grants and contributions not restricted to specific programs				4,766,213		
Interest, fines and penalties				25,428		
Miscellaneous				1,285,556		
Total general revenues				7,797,463		
Change in net assets				151,401	(106,056)	
Net assets at beginning of year				10,796,349	(522,657)	
Net assets at end of year				\$ 10,947,750	\$ (628,713)	

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

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

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

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Housing and Urban Development Programs</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	\$ 773,615	\$ 383,891	\$ -	\$ -	\$ -	\$ 1,157,506
Due to other funds (Note 9)	925,422	67,036			173,106	1,165,564
Due to other agencies (Note 11)	1,066,240	73,700				1,139,940
General obligations:						
Bonds			150,000			150,000
Interest			38,991			38,991
Claims and judgement	475,000					475,000
Deferred revenues: (Note 12)						
Municipal licence tax	490,947					490,947
Federal government		141,795			288,548	430,343
Total liabilities	<u>3,731,224</u>	<u>666,422</u>	<u>188,991</u>	<u>-</u>	<u>461,654</u>	<u>5,048,291</u>
Fund Balances (Deficit)						
Reserved for:						
Encumbrances	43,341					43,341
Debt service			134,555			134,555
Unreserved fund balance (deficit)	(2,264,524)			2,368,172		103,648
Total fund balance/(deficit)	<u>(2,221,183)</u>	<u>-</u>	<u>134,555</u>	<u>2,368,172</u>	<u>-</u>	<u>281,544</u>
Total liabilities and fund balance (deficit)	<u>\$ 1,510,041</u>	<u>\$ 666,422</u>	<u>\$ 323,546</u>	<u>\$ 2,368,172</u>	<u>\$ 461,654</u>	<u>\$ 5,329,835</u>

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

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

Total fund balances - governmental funds	\$ 281,544
--	------------

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

- | | |
|--|--------------------|
| <ul style="list-style-type: none"> • Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet | 15,152,923 |
| <ul style="list-style-type: none"> • 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>(4,486,717)</u> |

Net assets of governmental activities	<u>\$ 10,947,750</u>
---------------------------------------	----------------------

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

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

	General	Housing and Urban Development Programs	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes (Note 6)	\$ 888,976	\$ -	\$ 268,364	\$ -	\$ -	\$ 1,157,340
Municipal license taxes (Note 7)	562,926					562,926
Licenses, permits, and other local taxes	249,268					249,268
Charges for services	454,466					454,466
Intergovernmental revenues (Note 13):						
Federal grants and contributions		1,501,946			564,739	2,066,685
State contributions	4,516,945			329,865		4,846,810
Interest, fines, and penalties	23,718		1,710			25,428
Other revenues	872,705					872,705
Total revenues	<u>7,569,004</u>	<u>1,501,946</u>	<u>270,074</u>	<u>329,865</u>	<u>564,739</u>	<u>10,235,628</u>
EXPENDITURES						
Current:						
General government	3,837,414					3,837,414
Public safety	781,793					781,793
Public works	2,522,271					2,522,271
Culture and recreation	281,087					281,087
Health and welfare	662,806	743,806			564,739	1,971,351
Capital outlays		758,140		376,932		1,135,072
Debt service:						
Principal			556,213			556,213
Interest and other			147,466			147,466
Total expenditures	<u>8,085,371</u>	<u>1,501,946</u>	<u>703,679</u>	<u>376,932</u>	<u>564,739</u>	<u>11,232,667</u>
Deficiency of revenues over expenditures	<u>(516,367)</u>	<u>-</u>	<u>(433,605)</u>	<u>(47,067)</u>	<u>-</u>	<u>(997,039)</u>
OTHER FINANCING SOURCES (USES)						
Operating transfers from other funds	1,621		487,758			489,379
Proceeds from issuance of long-term debt	250,000					250,000
Settlement of AEE	412,851					412,851
Operating transfers to other funds	(487,758)		(1,621)			(489,379)
Total other financing sources (uses)	<u>176,714</u>	<u>-</u>	<u>486,137</u>	<u>-</u>	<u>-</u>	<u>662,851</u>
Excess (deficiency) of revenues over (under) expenditures and other financing sources (uses)	<u>(339,653)</u>	<u>-</u>	<u>52,532</u>	<u>(47,067)</u>	<u>-</u>	<u>(334,188)</u>
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	<u>(1,881,530)</u>		<u>82,023</u>	<u>2,415,239</u>		<u>615,732</u>
FUND BALANCE (DEFICIT) AT END OF YEAR	<u>\$ (2,221,183)</u>	<u>\$ -</u>	<u>\$ 134,555</u>	<u>\$ 2,368,172</u>	<u>\$ -</u>	<u>\$ 281,544</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
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 \$ (334,188)

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. 1,135,072
- Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (713,732)
- Governmental funds report issuance of long-term debt as other financial sources because provides current financial resources. (250,000)
- 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. 556,213
- 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. (241,964)

Changes in net assets of governmental activities \$ 151,401

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
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	\$ 919,620	\$ 919,620	\$ 888,976	\$ (30,644)	\$ 277,638	\$ 277,638	\$ 268,364	\$ (9,274)
Municipal license taxes	690,432	690,432	562,926	(127,506)				
Licenses, permits, and other local taxes	1,359,708	1,359,708	249,268	(1,110,440)				
Charges for services	1,063,944	1,063,944	454,466	(609,478)				
Intergovernmental revenues	3,986,016	3,986,016	4,516,945	530,929				
Interest, fines, and penalties	10,008	10,008	25,339	15,331			1,710	1,710
Other revenues	262,248	262,248	1,535,556	1,273,308				
Total revenues	8,291,976	8,291,976	8,233,476	(58,500)	277,638	277,638	270,074	(7,564)
EXPENDITURES								
Current:								
General government	3,754,920	3,754,920	3,841,523	(86,603)				
Public safety	876,228	876,228	781,793	94,435				
Public works	2,630,460	2,630,460	2,522,271	108,189				
Culture and recreation	303,012	303,012	281,087	21,925				
Health and welfare	727,356	727,356	662,806	64,550				
Debt service:								
Principal				-	247,828	247,828	556,213	(308,385)
Interest				-	29,810	29,810	147,466	(117,656)
Total expenditures	8,291,976	8,291,976	8,089,480	202,496	277,638	277,638	703,679	(426,041)
Excess of expenditures over revenues	\$ -	\$ -	\$ 143,996	\$ 143,996	\$ -	\$ -	\$ (433,605)	\$ (433,605)

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

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

1. ORGANIZATION

The Municipality of Ciales, Puerto Rico (Municipality) was founded in 1815. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of the municipal character, with perpetual succession existence and legal personality, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, culture and recreation as well as many other general and administrative 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 12 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 - The new 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 CIALES
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 appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component 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.

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

The Colinas de Jaguas Project is included in the basic financial statements as a discretely component unit because of the nature of the services they provide and the Municipality's ability to impose its will.

Colinas de Jaguas Project is a 54-unit multi-family housing project owned by the Municipality as authorized transfer from the Special Trustee for the Liquidation of the Accounts of the Puerto Rico Urban Renewal and Housing Corporation. The Project is operated under Section 515 of USDA, Rural Development (USDA-RD) and regulated by the U. S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreements with HUD, and a significant portion of the Project's rental income is received from HUD. Also, the Project is financed by a Mortgage of Section 515 Direct Loan.

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.

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

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.

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.

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

2) Housing and Urban Development Programs (HUD Programs)

This fund account for revenue sources for the development of viable urban communities, decent housing, suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low-income family.

3) 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.

4) Capital Projects 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.

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.

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

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 and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts 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).

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.

e. Interfund Receivables and Payables

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

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:

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

	<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.

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 approximately \$210,683. The

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

current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$165,980 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.

j. 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 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.

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

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) 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	Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements.	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 for Employers for Post-employment Benefits Other than Pensions	2009-10

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

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

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

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.

The annual budget is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2004 representing the original budget.

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

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

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 and debt service funds:

	<u>Debt Service</u>
Excess of expenditures over revenues - budgetary basis	(\$433,605)
Entity differences:	
Non-budgeted transfers	487,758
Non-budgeted revenues	(<u>1,621</u>)
Excess of expenditures over revenues - GAAP basis	\$ <u>52,532</u>

Explanation of differences:

<u>Sources/inflows of resources</u>	<u>General Fund</u>
Actual amounts (budgetary basis) "available appropriation" from the budgetary comparison schedule	\$8,233,476
Differences-budget to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(1,621)
Proceeds from settlement with AEE are inflows of budgetary resources but are not revenues for financial reporting purposes	(412,851)
The proceeds from the issuance of long-term debt are budgetary resources but are regarded as Other Financing Sources for financial reporting purposes	(<u>250,000</u>)
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances	\$ <u>7,569,004</u>

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

Uses/outflows of resources

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$8,089,480
Differences-budget to GAAP:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	39,232
Current year encumbrances recorded as expenditures for budgetary purposes	(<u>43,341</u>)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances	<u>\$8,085,371</u>

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 \$4.5 million difference are as follows:

Bonds payable	\$ 769,000
Compensated absences	1,053,918
Note payable	1,645,824
Obligation under capital leases	107,820
Other long-term liabilities	<u>910,155</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$4,486,717</u>

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

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 are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$589,000 in the general fund were fully collateralized at June 30, 2004. In addition, the HUD Programs and other governmental funds, maintain deposits with commercial banks of approximately \$218,000 and \$351,000, respectively, that were fully collateralized.

The deposits at GDB of approximately \$1.1 million that are restricted principally for capital projects, and the \$323,500 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its investments in two (2) 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 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.

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

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.

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 ensuring 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

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

advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. 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 \$1.1 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 2002-03, 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 \$30,646. Such amount is presented as intergovernmental payable in the general fund in the basic financial statements (refer to Note 11).

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

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

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 Ciales, are as follows:

Savings and loans associations	= 1.00%
Financial institutions	= 1.50%
Other organizations:	
Up to \$500,000	= .40%
Over \$500,000	= .50%

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 approximately \$490,947, 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	\$ 680,213
U.S. Department of Housing and Urban Development	445,181
Commissioner Office of Municipal Affair	312,800
U.S. Department of Education	<u>110,102</u>
	<u>\$1,548,296</u>

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

9. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2004, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Capital Project	General	\$ 925,422
General	HUD	67,036
General	Other Governmental Funds	<u>173,106</u>
		<u>\$1,165,564</u>

The balance of \$925,422 due to the general fund from the capital projects fund represents amount due from prior years related to state contributions grants.

Remaining transfers are used to use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

b. 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>
Debt Service	General	\$487,758
General Fund	Debt Service	<u>1,621</u>
		<u>\$489,379</u>

The transfers are used to (1) move revenues from the fund that statute or budget revenues to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the fund collection the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various

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

programs accounted for in other funds in accordance with budgetary authorizations.

10. CAPITAL ASSETS

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

<u>Primary Government</u>	<u>Balance July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2004</u>
Governmental Activities:				
Capital assets, not being depreciated:				
Land	\$ 1,706,856	\$ -	\$ -	\$ 1,706,856
Construction in progress	1,193,365	254,821	-	1,448,186
Total capital assets, not being depreciated	<u>2,900,221</u>	<u>254,821</u>	<u>-</u>	<u>3,155,042</u>
Capital assets, being depreciated:				
Land improvements	420,781	-	-	420,781
Buildings and building improvements	4,666,154	109,440	-	4,775,594
Furniture and fixtures	196,875	63,993	-	260,868
Vehicles and equipment	1,833,514	95,234	-	1,928,748
Infrastructure	9,177,520	611,585	-	9,789,105
Total capital assets, being depreciated	<u>16,294,844</u>	<u>880,252</u>	<u>-</u>	<u>17,175,096</u>
Less accumulated depreciation for:				
Land improvements	229,728	28,052	-	257,780
Buildings and building improvements	1,071,419	160,369	-	1,231,788
Furnitures and fixtures	134,651	36,042	-	170,693
Vehicles and equipment	982,883	244,542	-	1,227,425
Infrastructure	2,044,802	244,727	-	2,289,529
Total accumulated depreciation	<u>4,463,483</u>	<u>713,732</u>	<u>-</u>	<u>5,177,215</u>
Total capital assets, being depreciated, net	<u>11,831,361</u>	<u>166,520</u>	<u>-</u>	<u>11,997,881</u>
Governmental activities capital assets, net	<u>\$ 14,731,582</u>	<u>\$ 421,341</u>	<u>\$ -</u>	<u>\$ 15,152,923</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
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	\$403,046
Public safety	49,379
Public works	71,076
Culture and recreation	122,367
Health and welfare	22,596
Education	<u>45,269</u>
 Total depreciation expense - governmental activities	 <u>\$713,732</u>

Capital asset activity for Colinas de Jaguas Project, a discretely presented component unit, for the year ended June 30, 2004 was as follows:

<u>Component Unit- Colinas de Jaguas Project</u>	<u>Balance July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2004</u>
Capital assets, not being depreciated:				
Land	\$ 60,000	\$ -	\$ -	\$ 60,000
Total capital assets, not being depreciated	<u>60,000</u>	<u>-</u>	<u>-</u>	<u>60,000</u>
Capital assets, being depreciated:				
Buildings, equipment, and furniture	2,356,846	329		2,357,175
Total capital assets, being depreciated	<u>2,356,846</u>	<u>329</u>	<u>-</u>	<u>2,357,175</u>
Less accumulated depreciation for:				
Buildings, equipment, and furniture	1,378,452	113,236		1,491,688
Total accumulated depreciation	<u>1,378,452</u>	<u>113,236</u>	<u>-</u>	<u>1,491,688</u>
Total capital assets, being depreciated, net	<u>978,394</u>	<u>(112,907)</u>	<u>-</u>	<u>865,487</u>
Colinas de Jaguas Project capital assets, net	<u>\$ 1,038,394</u>	<u>\$ (112,907)</u>	<u>\$ -</u>	<u>\$ 925,487</u>

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

11. DUE TO OTHER AGENCIES

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

Puerto Rico Electric Power Authority	\$ 596,715
Treasury Department	79,745
Retirement System Administration	298,783
CRIM	30,646
State Insurance Fund	17,654
U. S. Department of Housing and Urban Development	73,700
General Services Administration	11,472
Municipality of Florida	<u>31,225</u>
 Total	 <u>\$1,139,940</u>

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately \$490,947 in the general fund related to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

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.

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.

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

14. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2004 are as follows:

Bonds

\$181,000 series of 1989, payable in annual installments of \$12,000 to \$14,000 until January 1, 2017, interest at 5%.	\$124,000
\$145,000 series of 1997, payable in annual installments of \$10,000 to \$20,000 until July 1, 2006, interest from 4.70% to 6%	40,000
\$400,000 series of 1996, payable in annual installments of \$10,000 to \$40,000 until July 1, 2016, interest from 5% to 8%.	300,000
\$80,000 series of 2003, payable in annual installments of \$10,000 to \$15,000 until July 1, 2009, interest from 5% to 6.5%.	60,000
\$250,000 series of 2004, payable in annual installments of \$5,000 to \$25,000 until July 1, 2028, interest from 5% to 8%.	<u>245,000</u>
Total bonds payable	<u>\$769,000</u>

Notes Payable

Note payable of \$1,174,924 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 \$15,373 plus interest rate of 5.826%.	\$1,145,824
---	-------------

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

Note payable of \$785,000, serie 2001, its payable in annual installments of \$85,000 to \$140,000 until July 2008, interest from 5% to 8%.	\$ <u>500,000</u>
Total notes payable	\$ <u>1,645,824</u>
 <u>Other Long-Term Liabilities</u>	
Due to the Treasury Department, payable in monthly installments of \$4,841 until 2005.	\$ 58,048
Due to the Treasury Department, payable in monthly installments of	112,374
Due to Municipality of Toa Baja, payable in monthly installments of \$3,537.	113,180
Due to Puerto Rico Water and Sewer Authority, payable in monthly installments of \$1,495.	<u>55,271</u>
Total other long-term liabilities	<u>\$338,873</u>
 <u>Due to Puerto Rico Health Insurance Administration</u>	
Due to the Puerto Rico Health Insurance Administration represents the municipal contribution related to the Health Care Reform corresponding to the period from December 1, 1995 through June 30, 1997. This balance will be paid through amounts retained by the CRIM from the participation in the Municipal Equalization Fund of the Additional Lottery System.	<u>\$571,281</u>

Obligations under Capital Leases

The Municipality of Ciales is obligated under capital lease for equipment as follow: Lease payable to AA Public Finance Co., Inc., payable in semiannual installments of \$19,225.05 (including interest at 7.5%) collateralized by a garage.

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

The minimum future lease payments under capital leases are as follows:

<u>Period Ending June 30,</u>	<u>Amount</u>
2005	\$ 31,027
2006	33,327
2007	33,144
2008	<u>10,322</u>
	<u>\$107,820</u>

Component Unit

The original mortgage, in the amount of \$1,945,000 were payable to Rural Housing Service (RHS) and were collateralized by the apartment complex. The required monthly principal and interest payments totaled \$11,053. On November 14, 1997, the mortgages on the property were transferred from the Puerto Rico Urban and Housing Corporation to the new owner, the Municipality of Ciales. Rural Housing Service, the mortgagee, recalculated and adjusted the amortization of the mortgages at the time, resulting in a smaller monthly payment. The revised payments of the three mortgages commenced on December 1, 1997.

Under agreements with RHS, the project is required to make monthly escrow deposits for insurance and replacement of Project assets, and is subject to restrictions as to operating policies, rental charges and operating expenditures.

The liability of the Project under the mortgages is limited to the underlying value of the real estate, plus other amounts deposited with the lender.

The mortgages are insured by RHS, collateralized by the Project, and consist of the following:

Interest at 6.5%, payable in monthly installments of \$8,159, including interest, through the due date, December 2031.	\$1,281,539
--	-------------

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

Interest at 8.75%, payable in monthly installments of \$2,351, including interest, through the due date, December 2031.	\$ 297,517
Interest at 11.25%, payable in monthly installments of \$543, including interest, through the due date, December 2032.	<u>55,857</u>
Less current maturities	<u>1,634,913</u> <u>14,291</u>
	<u><u>\$1,620,622</u></u>

The interest rates shown above are net of 2% interest rental credit.

Aggregate maturities of the mortgage payable for each of the next five years following June 30, 2004 and thereafter, are as follows:

<u>Year Ended</u> <u>June 30,</u>	<u>Amount</u>
2005	\$ 14,291
2006	15,611
2007	17,053
2008	18,630
2009	20,357
Thereafter	<u>1,548,971</u>
	<u><u>\$1,634,913</u></u>

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

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

	<u>Bonds</u>		<u>Note Payable</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 57,000	\$ 45,010	\$ 124,713	\$ 95,110
2006	62,000	47,500	135,714	90,932
2007	43,000	43,400	146,782	86,010
2008	48,000	40,450	157,922	80,267
2009	48,000	37,175	19,140	73,618
2010-2014	219,000	141,150	117,077	346,713
2015-2019	157,000	63,300	162,653	301,136
2020-2024	65,000	33,600	225,972	237,818
2025-2029	70,000	11,400	313,940	149,850
2030-2032	70,000	11,400	241,911	33,941
	<u>\$ 769,000</u>	<u>\$ 462,985</u>	<u>\$ 1,645,824</u>	<u>\$ 1,495,395</u>

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

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

<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	\$ 571,000	\$ 250,000	\$ 52,000	\$ 769,000	\$ 57,000
Note payable	1,764,601		118,777	1,645,824	124,713
Total long-term debt	<u>2,335,601</u>	<u>250,000</u>	<u>170,777</u>	<u>2,414,824</u>	<u>181,713</u>
Other long-term liabilities:					
State Health Insurance Plan	819,453		248,172	571,281	248,000
Due to Puerto Rico Treasury Department	247,296		76,873	170,423	76,777
Due to Puerto Rico Labor Department	21,140		21,140	-	-
A. A. Public Finance Co.	136,707		28,887	107,820	33,327
P. R. Water and Sewer Authority		65,736	10,465	55,271	17,939
Municipality of Toa Baja		113,180		113,180	42,442
Compensated absences	834,089	301,059	81,230	1,053,918	87,345
Total other long-term liabilities	<u>2,058,685</u>	<u>479,975</u>	<u>466,767</u>	<u>2,071,893</u>	<u>505,830</u>
Total noncurrent liabilities, governmental activities	<u>\$ 4,394,286</u>	<u>\$ 729,975</u>	<u>\$ 637,544</u>	<u>\$ 4,486,717</u>	<u>\$ 687,543</u>
Component Unit:					
Colinas de Jaguas Project mortgage payable	<u>\$ 1,647,996</u>	<u>\$ -</u>	<u>\$ 13,083</u>	<u>\$ 1,634,913</u>	<u>\$ 14,291</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.

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

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 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 ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 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.

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

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 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 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 approximately \$214,809. The Municipality's payroll for employees covered by ERS was approximately \$2.3 million. The Municipality total payroll for all employees was approximately \$3.7 million.

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.

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

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.

17. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place 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 \$62,737.
- 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.

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

- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. The Municipality has reported liabilities of \$475,000 for awarded and anticipated unfavorable judgments as of June 30, 2004. This amount was reported within claims and judgments liabilities in the fund financial statements and government-wide statement of net assets. Management believes that the liability in excess of amounts provided, if any, would not be significant.

19. COMMITMENTS

The Municipality of Ciales had several outstanding or planned construction projects as of June 30, 2004. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$20,000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
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)		
Section 8 - Housing Choice Voucher Pass-through Commissioner Office of Municipal Affairs - Community Development	14.871	\$ 266,044
Block Grants/State Program - SBGP	14.228	<u>1,235,902</u>
Subtotal U.S. Department of HUD		<u>1,501,946</u>
U. S. Department of Agriculture		
Business and Industrial Loans (FMHA Rural Development Loan Fund)	10.422	54,149
Pas-through Governor's Office of Child Services and Community Development: Child and Adult Care Food Program	10.558	<u>24,928</u>
Subtotal U. S. Department of Agriculture		<u>79,077</u>
U. S. Federal Emergency Management Agency Public Assistance Grants (FEMA)		
Disaster Assistance	83.545	<u>8,990</u>
Subtotal FEMA		<u>8,990</u>
U. S. Department of Education (DE)		
Even Start-State Educational Agencies	84.213	<u>129,844</u>
Subtotal U. S. Department of DE		<u>129,844</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	<u>346,828</u>
Subtotal U. S. Department of HHS		<u>346,828</u>
TOTAL		<u>\$2,066,685</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES 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 Ciales 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.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Expenditures as per basic financial statements:	
Housing and Urban Development Programs	\$1,501,946
Included within other governmental funds	<u>564,739</u>
Total expenditures per schedule of expenditures of federal awards	<u>\$2,066,685</u>



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 Ciales
Ciales, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Municipality of Ciales 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 15, 2004. The report on General Fund and Capital Project was qualified because not reconcile the cash accounts balances. Except as discuss in the preceding sentence, 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 Ciales'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*.



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 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 Ciales
Ciales, Puerto Rico

Compliance

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

In our opinion, Municipality of Ciales 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 04-01.

Internal Control over Compliance

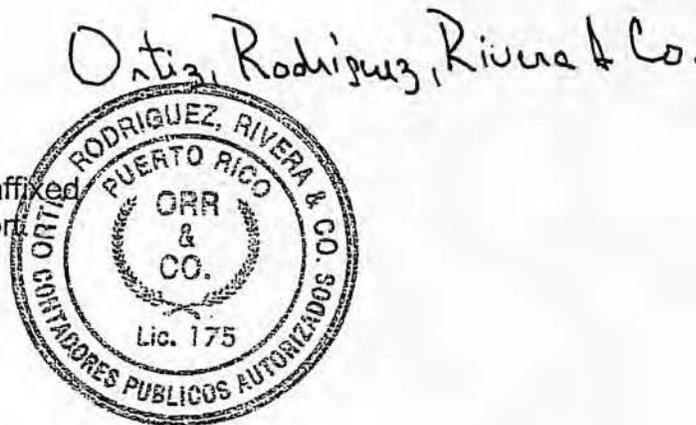
The management of Municipality of Ciales is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Ciales's 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.

San Juan, Puerto Rico
December 15, 2004

The stamp 2000973 was affixed
to the original of this report



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
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 qualified opinion on the basic financial statements of the Municipality of Ciales.
- b. There were no reportable conditions on internal controls.
- c. No instances of noncompliance material to the financial statements of Municipality of Ciales were disclosed during the audit.
- d. There were no reportable conditions on internal controls over major programs.
- e. The auditor's report on compliance with requirements applicable to federal award programs for Municipality of Ciales express an unqualified opinion.
- f. Audit findings relative to the major federal award programs for the Municipality of Ciales are reported in number 3 of this schedule.
- g. The program tested as major programs is SBGP - CFDA No. 14.228.
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Ciales was determined to be a high-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None.

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

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
SBGP CFDA No. 14.228	<p>Condition 04-1</p> <p>The program did not comply with the procedures require for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees.</p> <p><u>Cause</u></p> <p>The program does not have adequate control procedures for the cash management.</p> <p><u>Effect</u></p> <p>The continued occurrence of this condition may expose the Municipality to the assessment of interest costs on the excess cash on hand, which would be paid from local funds.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.</p> <p><u>Recommendation</u></p> <p>The disbursements of funds should be made for not more than three days after received, in order to comply with the cash management requirement.</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
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 CIALES
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 03-1 The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis.	Condition was corrected.
Section 8 - CFDA No. 14.855	Condition 03-2 The Municipality did not comply with the requirement of preparing and filing its SEMAP report on a timely basis. The score for the Municipality is Zero (0).	Condition was not observed.
Section 8 - CFDA No. 14.855	Condition 03-3 We do not observe any procedures of HQS Quality Control in two files which any life-threatening deficiencies are corrected within 24 hours from the inspection and all other cited deficiencies are corrected within no more than 30 calendar days from the inspection or any approved extension.	Condition was not observed.
Section 8 - CFDA No. 14.855	Condition 03-4 The Municipality does not maintained the required documents and information in each file to support participants' eligibility as required by HUD regulation. We noted that two files do not include a participant's sign required in the fiscal inspection document.	Condition was not observed.

EXHIBIT I

CORRECTIVE ACTION PLAN

*ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL
MUNICIPIO DE CIALES*

*HON. LUIS O. MALDONADO RODRIGUEZ
ALCALDE*

*TEL. (787) 871-3500
FAX (787) 871-1486
P.O. BOX 1408
CIALES, PR 00638*

CORRECTIVE ACTION PLAN

January 26, 2005

Cognizant or Oversight Agency for Audit:

Municipality of Ciales 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 disbursements of funds should be made for not more than three days after received, in order to comply with the cash management requirement.

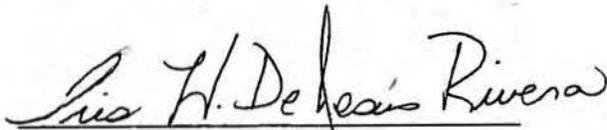


Action Taken

The Municipality will establish an internal system which the disbursement vouchers were authorized before request the federal funds to OCAM.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Iris De Jesús at (787) 871-3500.

Sincerely yours,



Iris De Jesús
Federal Program Director

