

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

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

TABLE OF CONTENTS

COMISIONADO
 29 JAN 29 PM 3:18
 RECIBIDO
 UNIDAD DE COSTAS

Conf 401-0698

		<u>PAGE</u>
I.	FINANCIAL SECTION:	
	Independent Auditors' Report	1 - 2
	Management's Discussion and Analysis	3 - 12
	Basic Financial Statements:	
	Government-wide Financial Statements:	
	Statement of Net Assets	14
	Statement of Activities	15
	Fund Statements:	
	Balance Sheet-Governmental Funds	16 - 17
	Statements of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds	18 - 19
	Notes to Financial Statements	20 - 41
	Required Supplementary Information:	
	Budgetary Comparison Schedule – General Fund	43
	Notes to Budgetary Comparison Schedule	44 - 45
	Schedule of Expenditures of Federal Awards	46
	Notes to Schedule of Expenditures of Federal Awards	47
II.	REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	48 - 49
III.	REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133	50 - 51
IV.	SCHEDULE OF FINDINGS AND QUESTIONED COSTS	52

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

JAN 29 PM 3:18
P.O. BOX 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

INDEPENDENT AUDITORS' REPORT

Mayor and Members of the Municipal Legislature
Municipality of Hormigueros
Hormigueros, 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 Hormigueros, Puerto Rico, as of and for the year ended June 30, 2003, 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 an opinion on these financial statements based on our audit.

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

As more fully described in Note H, the Municipality has not determined an adequate estimate of the solid waste landfill closure and post closure care costs as required by generally accepted accounting principles. The effect of this departure from U.S. generally accepted accounting principles on the accompanying financial statements is not reasonably determinable.

In our opinion, based on our audit, except for the effects of not including an adequate estimate of the solid waste landfill closure and post closure costs, the basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hormigueros, as of June 30, 2003, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note A, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for States and Local Governments*; GASB Statement No. 37 "*Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus-an amendment of GASB Statements No. 21 and No. 34*"; GASB Statement No. 38 "*Certain Financial Statements Note Disclosures*"; and GASB Statement No. 41 "*Budgetary Comparison Schedules-Perspective Differences-an amendment of GASB Statement No. 34*, as of June 30, 2003.

The Management's Discussion and Analysis on pages 3 through 12 and the Budgetary Comparison Schedule – General Fund on page 43 are not required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated January 14, 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 and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Municipality of Hormigueros, Puerto Rico, taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget and Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations", and is not a required part of the basic financial statements. Such information in that schedule 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 basic financial statements taken as a whole.



San Juan, Puerto Rico
January 14, 2004

Stamp 1933756 was affixed
to the original

MANAGEMENT DISCUSSION AND ANALYSIS

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

On July 1, 2002 the Management of the Municipality of Hormigueros implemented Statement No. 34 of the Governmental Accounting Standards Board (GASB) "*Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*". As a result of the requirements of such statement, a Management Discussion and Analysis (MD&A) is prepared. The MD&A is designed to introduce the basic financial statements and provide an analytical overview of the financial activities of the Municipality. Since it focus on current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

FINANCIAL HIGHLIGHTS

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2003 by \$23,788,519 (net assets).
- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$6,759,962, an increase of \$2,000,093 in comparison with the prior year. Approximately 38 percent of the total combined fund balances is unreserved.
- The General Fund, on a current financial resources basis, reported an excess of revenues and other financing sources over expenditures and other financing uses of \$1,023,870.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$ 763,740.
- The investment in capital assets as of June 30, 2003 was \$27,182,581 (net of depreciation).
- Long term debt increased to \$10,936,021, approximately 16 percent with respect to prior year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Municipality's of Hormigueros basic financial statements. The Municipality's basic financial statements comprise three components:

- government-wide financial statements
- fund financial statements
- notes to the financial statements.

This report also contains other supplementary information in addition to the basic financial statements themselves.

In the past, the primary focus of local government financial statements has been summarized fund type information on a current financial resources basis. However, with the implementation of Statement No. 34 of the Governmental Accounting Standards Board (GASB Statement No. 34) for June 30, 2003, the new focus is on both the Municipality as a whole (government-wide) and the fund financial statements. Each view provides a different snapshot of the Municipality's finances. The government-wide financial statements, which are new for fiscal year 2003, provide both long-term and short-term information about the Municipality's overall financial status. The fund financial statements, which have been provided in the past, focus on the individual parts of the Municipality's government, reporting the Municipality's operations in more detail than the government-wide statements. Both perspectives (government-wide and fund) allow the user to address relevant questions, broaden the basis of comparison (year-to-year or government-to-government) and enhance the Municipality's accountability.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

Government-Wide Statements

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector companies. The Statement of Net Assets and the Statement of Activities, which are the government-wide statements, include all of the government's assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. These two government-wide statements report the Municipality's net assets and how they have changed. Net assets (the difference between the Municipality's assets and liabilities) is one way to measure the Municipality's financial health, or financial position. Over time, increases or decreases in the Municipality's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's roads and other infrastructure may need to be considered to assess the overall health of the Municipality.

Fund Financial Statements

The format of the fund financial statements will be more familiar to traditional users of government financial statements. The fund financial statements provide more detailed information about the Municipality's most significant funds – not the Municipality as a whole. Funds are accounting mechanisms that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Federal and Commonwealth regulations require some funds, as well by bond covenants. The Municipality's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances remaining at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The Total Governmental Funds column requires reconciliation because of the different measurement focus from the government-wide statements (current financial resources versus total economic resources) which is reflected on the page following each statement. The flow of current financial resources will reflect bond proceeds and interfund transfers as other financing sources as well as capital expenditures and bond principal payments as expenditures. The reconciliation will eliminate these transactions and incorporate the capital assets and long-term obligations (bonds and others) into the Governmental Activities column of the government-wide statements.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

This is the first year that the Municipality has presented its financial statements under the new reporting model required by GASB Statement No. 34. This reporting model changes significantly both the recording and presentation of financial data. However, under this statement, the Municipality is not required to restate prior periods for the purposes of providing comparative information. In future years, when prior year information becomes available, a comparative analysis of government-wide information will be included in this report.

Net assets

TABLE 1

**Condensed Statement of Net Assets
June 30, 2003**

Assets	
Current and other assets	\$ 10,028,583
Capital assets	27,182,581
Total assets	<u>\$ 37,211,164</u>
Liabilities	
Current and other liabilities	\$ 2,486,624
Long term liabilities	10,936,021
Total liabilities	<u>13,422,645</u>
Net assets	
Invested in capital assets, net of related debt	21,082,279
Restricted	2,059,667
Unrestricted	646,573
Total net assets	<u>\$ 23,788,519</u>

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. At the end of the current fiscal period, the Municipality reported positive balances of net assets. The largest portion of the Municipality's net assets (88%) reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure); less accumulated depreciation and less any related outstanding debt used to acquire those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt. Approximately 8% of the Municipality's net assets are subject to external restrictions. The remaining balance of unrestricted net assets (4%) may be used to meet the Municipality's ongoing obligations to citizens and creditors.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

Changes in net assets

TABLE 2

**Condensed Statement of Activities
Fiscal year ended June 30, 2003**

Program revenues:	
Fees, fines and charges for services	\$ 1,279,289
Operating grants and contributions	1,083,493
Capital grants and contributions	1,760,050
General revenues:	
Property taxes	3,528,009
Municipal license taxes	1,120,701
Grants and contributions not restricted to specific programs	3,214,127
Interest	110,967
Other	164,835
Total revenues	<u>12,261,471</u>
Expenses:	
General government	5,903,852
Public works and sanitation	2,234,270
Public safety	666,858
Culture and recreation	780,416
Health	352,184
Welfare and community development	1,411,749
Education	27,118
Interest on long term debt	371,068
Total expenses	<u>11,747,515</u>
Change in net assets	513,956
Net assets-beginning of year	<u>23,274,563</u>
Net assets-end of year	<u><u>\$ 23,788,519</u></u>

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

FIGURE 1

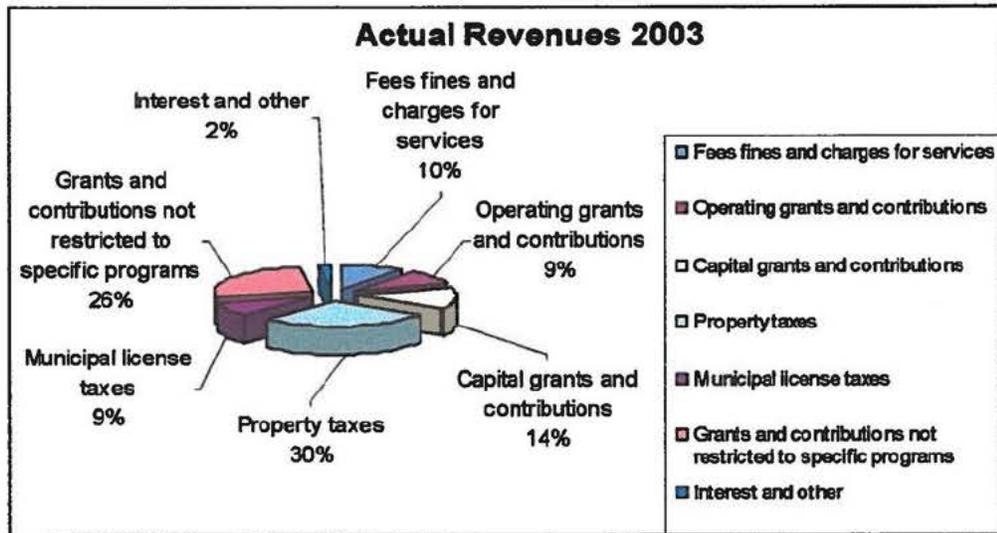
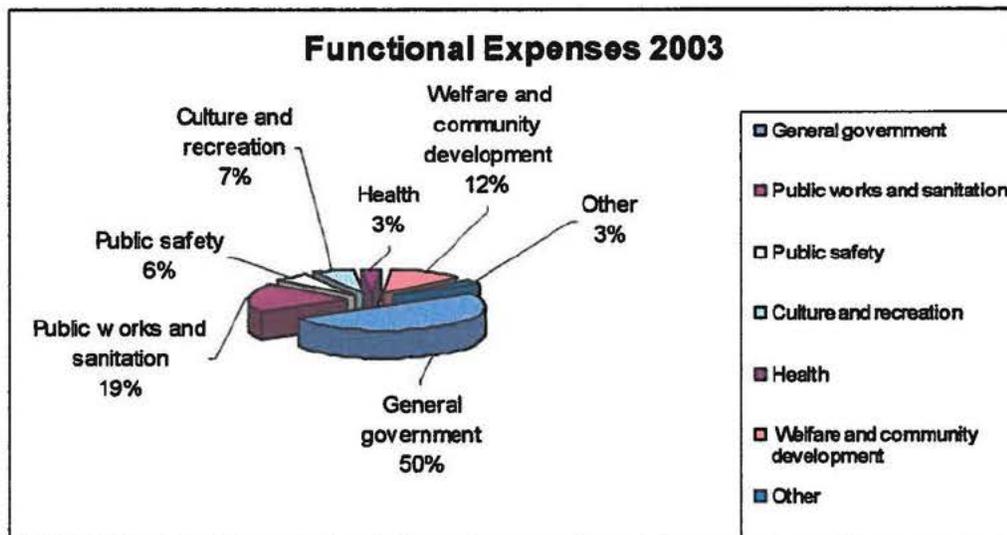


FIGURE 2



Approximately 30% of the Municipality's revenues came from property taxes and approximately 26% comes from grants and contributions. The remaining significant revenues are charges for services and capital grants and contributions. The Municipality's expenses cover a range of services. The largest expenses are general government, representing approximately 50%, public works and sanitation with 19% and welfare with 12%. Program revenues of the Municipality covered 35% of total expenses.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2003, the governmental funds reported combined ending fund balances of \$6,759,962, an increase of \$2,000,093 in comparison with the prior year. Of this amount, \$4,224,016 (62%) constitutes unreserved fund balance, of which \$2,592,625 is available for governmental spending and \$1,631,391 is designated by management for tentative spending plans. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents 38% of total combined ending fund balance. For the year ended, the fund balance of the general fund increased by \$1,023,870. The key factors of this increase are as follows:

- A net increase of \$268,243 in total revenues
- A net decrease of \$596,391 in total expenditures

The net increase in revenues was mainly due to increase of \$655,343 in collection of construction permits, since during the fiscal year the Municipality experienced an increase in construction projects. Also there was an increase of \$338,391 in intergovernmental revenues, mainly from revenues related to the municipal equalization fund sent by the Municipal revenue Collection Center (CRIM). The net decrease in expenditures was due to reductions of \$334,444 in general government expenditures and a \$166,470 in public works and sanitation expenditures, mainly in fuel, lubricants and repair and maintenance charges.

General fund budgetary highlights

The general fund original budget for the fiscal period 2002-2003 presented a decrease of 6% with respect to prior year budget due to a decrease in the estimated amount of compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA). The Municipal Legislature approves amendments to the original budget. During the fiscal year budget revenues were increased by \$519,398 due to additional collections for property taxes and construction permits. An amendment to budget expenditures of \$250,000 was approved, representing a readjustment of current year budget with prior year's budgetary surpluses. Actual revenues exceeded the revised budgeted revenues by \$972,194. The most significant variances were in municipal license taxes (\$162,475) due to certain business closings and the economic conditions in last year. Also, there were positive variances of \$600,235 in intergovernmental revenues due to excess compensation in lieu of tax and \$437,289 due to additional collections of construction permits.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

The Municipality reported a net positive variance of \$41,546 between revised budget and actual expenditures. A net negative variance of \$84,207 disclosed in general government function was due to charges for utilities by the Puerto Rico Electric Power Authority. The Municipality ended with a total net positive variance of \$763,740 for budgetary purposes.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$27,182,581 in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of 2.1% over the prior year.

TABLE 3

**Municipality of Hormigueros's Capital Assets
(net of depreciation)
June 30, 2003**

Non-depreciable assets:

Land	\$	3,186,599
Construction in progress		1,184,814

Depreciable assets:

Land improvements		892,863
Buildings and buildings improvements		10,686,543
Infrastructure		8,949,143
Vehicles, machinery and equipment		2,282,619
Total	\$	<u>27,182,581</u>

This year's major capital assets additions and decreases in construction in progress included:

- Completion of basketball court (San Romualdo) - \$165,061
- Improvements to parking lots (Sports complex) - \$71,824
- Improvements to roads (infrastructure) - \$199,055

The Municipality's fiscal year 2004 capital budget calls for approximately \$2,321,000 for capital projects. Of this amount, \$1,000,000 will be financed through a bond anticipation note from Rural Development (RD), for the construction of a sanitary sewer system (Lavadero). At the end of the project, ownership of this asset is transferred to the Puerto Rico Aqueduct and Sewer Authority (a Commonwealth public corporation), since this agency is responsible for sanitary sewer systems maintenance. The remaining projects will be financed with other federal grants, funds from the Commonwealth Legislature and Municipal funds. More detailed information about the Municipality's capital assets is presented in Note E to the financial statements.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

Long-term debt

At year-end, the Municipality had \$6,916,000 in general and special bonds and notes, a decrease of 5% with respect to prior year. The Municipality is required to maintain a legal debt margin of 10% of the total assessment of property located within the Municipality plus the balance of the property taxes in the debt service fund.

TABLE 4

**Municipality of Hormigueros's Outstanding Debt
June 30, 2003**

General and special obligation bonds and notes	\$ 6,916,000
Compensated absences	909,736
Claims and judgments	1,911,854
Bond anticipation note	1,040,000
Payable to CRIM – prior years doubtful accounts	158,431
Total	\$ 10,936,021

One of the settled cases recorded as claims and judgments in the amount of \$1,850,000 was refinanced on a long-term basis through a non-interest bearing operational loan from the Puerto Rico Department of Treasury issued on October 14, 2003. More detailed information about the Municipality's long term liabilities is presented in Note G to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's unemployment rate now stands at 11%, which compares with the Commonwealth rate of 12.7%. Declines in the region's economic conditions have led to less growth in sales and property taxes for the Municipality. These factors were considered when preparing the 2003-2004 fiscal years' budget.

As a result of these matters the Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2004 are \$7,110,552, an increase of approximately 6.8% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. Among planned projects, this budget included an increase in monthly salaries of \$100 and a \$1,000 Christmas bonus to all Municipal employees. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase modestly by the close of 2004 fiscal year.

Municipality of Hormigueros

MANAGEMENT DISCUSSION AND ANALYSIS (unaudited)

Fiscal year ended June 30, 2003

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Director of Finance at PO Box 97, Hormigueros, Puerto Rico 00660.

BASIC FINANCIAL STATEMENTS

MUNICIPALITY OF HORMIGUEROS

STATEMENT OF NET ASSETS

JUNE 30, 2003

	Governmental Activities
ASSETS	
Cash and cash equivalents	\$ 6,829,426
Cash with fiscal agents	1,812,238
Receivables, net	
Municipal license taxes (note C1)	13,176
Property taxes	84,923
Lease (note C2)	513,580
Due from	
Commonwealth Governmental entities (note C3)	629,571
Federal Government	78,236
Deferred charges (note A8)	67,433
Capital assets (note E):	
Land and construction in progress	4,371,413
Other capital assets, net	22,811,168
Total capital assets, net	<u>27,182,581</u>
 Total assets	 <u>\$ 37,211,164</u>
LIABILITIES	
Accounts payable	\$ 587,212
Accrued payroll taxes and withholdings	163,856
Matured bonds and notes payable	175,000
Matured interest payable	96,792
Due to	
Commonwealth Governmental entities	7,418
Federal Government	37,019
Deposits payable	63,362
Deferred revenues	
Municipal license taxes (note C1)	1,007,754
Intergovernmental-Commonwealth agencies (note F)	6,297
Federal grants (note F)	341,914
Long term liabilities (note G):	
Due within one year	3,579,486
Due in more than one year	7,356,535
Total liabilities	<u>13,422,645</u>
NET ASSETS	
Invested in capital assets, net of related debt	21,082,279
Restricted for:	
Capital projects	1,107,976
Debt service	868,893
Other purposes	82,798
Unrestricted	646,573
Total net assets	<u>\$ 23,788,519</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HORMIGUEROS

STATEMENT OF ACTIVITIES

FISCAL YEAR ENDED JUNE 30, 2003

Functions	Expenses	Program Revenues			Total
		Fees, Fines and Charges for services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General government	\$ 5,903,852	\$ 1,198,499	\$ 320,167	\$ 113,609	\$ (4,271,577)
Public works and sanitation	2,234,270	24,245	-	1,470,387	(739,638)
Public safety	666,858	-	69,850	-	(597,008)
Culture and recreation	780,416	56,545	-	-	(723,871)
Health	352,184	-	-	-	(352,184)
Welfare and community development	1,411,748	-	693,477	176,053	(542,218)
Education	27,118	-	-	-	(27,118)
Interest on long term debt	371,068	-	-	-	(371,068)
Total	\$ 11,747,514	\$ 1,279,289	\$ 1,083,494	\$ 1,760,049	(7,624,682)
General revenues					
					3,528,009
					1,120,701
					3,214,127
					110,967
					168,360
					(3,526)
					<u>8,138,638</u>
					513,956
					<u>23,274,563</u>
					<u>\$ 23,788,519</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HORMIGUEROS

BALANCE SHEET

GOVERNMENTAL FUNDS

JUNE 30, 2003

	General	Community Development Block Grant Program	Commonwealth Legislature Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
ASSETS						
Cash and cash equivalents	\$ 4,320,287	\$ 1,200	\$ 1,033,325	\$ -	\$ 1,474,614	\$ 6,829,426
Cash with fiscal agents	-	-	-	1,055,762	756,476	1,812,238
Receivables, net:						
Municipal license taxes (note C1)	13,176	-	-	-	-	13,176
Property taxes	-	-	-	84,923	-	84,923
Lease (note C2)	513,580	-	-	-	-	513,580
Due from:						
Commonwealth Governmental entities (note C3)	200,983	-	-	-	428,588	629,571
Federal Government	-	78,238	-	-	-	78,238
Other funds (note D1)	95,776	-	-	-	-	95,776
Total assets	<u>\$ 5,143,802</u>	<u>\$ 79,438</u>	<u>\$ 1,033,325</u>	<u>\$ 1,140,685</u>	<u>\$ 2,659,678</u>	<u>\$ 10,056,928</u>
LIABILITIES						
Accounts payable	\$ 348,845	\$ 71,985	\$ 14,183	\$ -	\$ 152,200	\$ 587,213
Accrued payroll taxes and withholdings	163,856	-	-	-	-	163,856
Matured bonds and notes payable	-	-	-	175,000	-	175,000
Matured interest payable	-	-	-	96,792	-	96,792
Due to:						
Commonwealth Governmental entities	7,418	-	-	-	-	7,418
Federal Government	-	-	-	-	37,019	37,019
Other funds	-	6,253	-	-	89,525	95,778
Deposits payable	63,362	-	-	-	-	63,362
Deferred revenues:						
Municipal license taxes (note C1)	1,007,754	-	-	-	-	1,007,754
Lease (note C2)	513,580	-	-	-	-	513,580
Intergovernmental-Commonwealth agencies	200,983	-	-	-	6,297	207,280
Federal grants	-	1,200	-	-	340,714	341,914
Total liabilities	<u>2,305,798</u>	<u>79,438</u>	<u>14,183</u>	<u>271,792</u>	<u>625,755</u>	<u>3,296,966</u>
FUND BALANCES						
Reserved for:						
Encumbrances	245,379	-	-	-	-	245,379
Debt service	-	-	-	868,893	-	868,893
Capital projects	-	-	1,019,142	-	402,532	1,421,674
Unreserved, designated for subsequent years expenditures, reported in:						
Special revenue fund	-	-	-	-	1,631,391	1,631,391
Unreserved, undesignated, reported in:						
General fund	2,592,625	-	-	-	-	2,592,625
Total fund balances	<u>2,838,004</u>	<u>-</u>	<u>1,019,142</u>	<u>868,893</u>	<u>2,033,923</u>	<u>6,759,962</u>
Total liabilities and fund balances	<u>\$ 5,143,802</u>	<u>\$ 79,438</u>	<u>\$ 1,033,325</u>	<u>\$ 1,140,686</u>	<u>\$ 2,659,678</u>	<u>\$ 10,056,928</u>

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HORMIGUEROS

**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES**

JUNE 30, 2003

Total governmental fund balances: \$ 6,759,962

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

Capital assets used in governmental activities are not financial
resources and therefore are not reported in the funds: 27,182,581

Other assets used in governmental activities are not current
financial resources and therefore are not reported in the funds:
Deferred charges: 67,433

Other assets are not available to pay current-period
expenditures and therefore are deferred in the funds:
Lease: \$ 513,580
Due from Commonwealth entities : 200,983 714,563

Long term liabilities, including bonds payable, are not due
and payable in the current period and therefore are not
reported in the funds:
General obligation bonds and notes: \$ 6,916,000
Bond anticipation notes: 1,040,000
Compensated absences: 909,736
Claims and judgments: 1,911,854
Doubtfull accounts debt payable to CRIM: 158,431 (10,936,021)

Net assets of governmental activities: \$ 23,788,519

MUNICIPALITY OF HORMIGUEROS
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2003

	General	Community Development Block Grant Program	Commonwealth Legislature Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes (note I)	\$ 2,528,129	\$ -	\$ -	\$ 878,120	\$ -	\$ 3,406,249
Municipal license taxes (note C1)	1,120,701	-	-	-	-	1,120,701
Intergovernmental (note J)	3,028,620	540,417	462,176	-	2,291,986	6,323,199
Fees, fines and charges for services	1,279,289	-	-	-	-	1,279,289
Interest	80,099	-	2,146	10,141	18,581	110,967
Other	99,170	-	-	-	-	99,170
Total revenues	8,136,008	540,417	464,322	888,261	2,310,567	12,339,575
Expenditures						
Current:						
General government	3,582,392	111,334	2,275	3,922	322,900	4,022,823
Public works and sanitation	1,667,399	-	-	-	49,153	1,716,552
Public safety	565,309	-	-	-	68,608	633,917
Culture and recreation	443,885	-	-	-	12,400	456,285
Health	352,184	-	-	-	-	352,184
Welfare and community development	418,208	102,904	72,769	-	707,983	1,301,864
Education	18,559	-	-	-	750	19,309
Capital outlays	-	332,647	233,633	-	575,660	1,141,940
Debt service						
Principal	-	-	-	387,000	-	387,000
Interest	-	-	-	371,068	-	371,068
Total expenditures	7,047,936	546,885	308,677	761,990	1,737,454	10,402,942
Excess (deficiency) of revenues over expenditures	1,088,072	(6,468)	155,645	126,271	573,113	1,936,633
Other financing sources (uses)						
Lease principal payments (note C2)	63,460	-	-	-	-	63,460
Operating transfers in	25,298	-	-	152,960	-	178,258
Operating transfers out	152,960	-	-	6,741	18,557	178,258
Total other financing sources (uses)	(64,202)	-	-	146,219	(18,557)	63,460
Net change in fund balance	1,023,870	(6,468)	155,645	272,490	554,556	2,000,093
Fund balance at beginning of year, as restated (note K)	1,814,134	6,468	863,497	596,403	1,479,367	4,759,869
Fund balance at end of year	\$ 2,838,004	\$ -	\$ 1,019,142	\$ 868,893	\$ 2,033,923	\$ 6,759,962

The accompanying notes are an integral part of this statement.

MUNICIPALITY OF HORMIGUEROS

RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

FISCAL YEAR ENDED JUNE 30, 2003

Net change in fund balances-total governmental funds: \$ 2,000,093

Amounts reported for governmental activities in the Statement of activities are different because:

Governmental funds reports capital assets 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.

Expenditures for capital assets:	\$ 1,462,612	
Less: current year depreciation	<u>(1,292,532)</u>	170,080

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:

(3,526)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Due from Commonwealth entities:

CRIM	\$ 121,759	
Puerto Rico Electric Power Authority (current year)	<u>79,224</u>	200,983

Revenues reported in funds which are not reported as revenues in the Statement of Activities

Due from Commonwealth entities:

Puerto Rico Electric Power Authority (prior year)		(339,024)
--	--	-----------

Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

401,946

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:

Judgment and claims:	\$ (1,911,854)	
Amortization of deferred charges:	<u>(4,742)</u>	(1,916,596)

Change in net assets of governmental activities: \$ 513,957

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Hormigueros was founded in 1874. The Municipality is governed by the executive and the legislative branch elected for a four-year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of twelve (12) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of the Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

In June 1999, the GASB issued Statement No. 34, "*Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*" which affects the way the Municipality prepares and presents financial information. This Statement, which establishes new requirements and a new reporting model for the annual reports of state and local governments, was developed to make annual reports easier to understand and more useful to the people who use the governmental financial information to make decisions.

Other GASB Statements are required to be implemented in conjunction with GASB 34. Therefore, the Municipality has implemented the following GASB Statements in the current fiscal year: GASB Statement No. 37 "*Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34*"; GASB Statement No. 38 "*Certain Financial Statement Note Disclosures*"; and GASB Statement No. 41 "*Budgetary Comparison Schedules—Perspective Differences—an amendment of GASB Statement No. 34*".

1. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality of Hormigueros (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The basic criteria for deciding financial accountability are any one of the following:

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and
 - 1) The primary government can impose its will on the potential component unit and/or
 - 2) A financial benefit/ burden exists between the primary government and the potential component unit.

There are two methods of presentation of the component unit in the financial statement:

- a. Blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances.
- b. Discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions:

The "Corporación para el Desarrollo Integral de Hormigueros", an entity organized in accordance with Chapter XVII of the Autonomous Municipal Law No. 81 of Puerto Rico as amended, and the "Corporación para el Desarrollo Industrial y Comercial de Hormigueros, Inc." are considered component units of the Municipality of Hormigueros since the Municipality is financially accountable for those Corporations. Both entities are not currently operating. Since the financial position and operations of those Corporations are not significant, the financial statements are not presented as part of the financial statements of the Municipality.

2. *Basis of presentation, measurement focus and basis of accounting*

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Government-wide statements

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes are recognized as revenues in the year for which they are levied. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated and the Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

Private-sector 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.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose, which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed.

The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion (percentage of the assets, liabilities, revenues or expenditures) or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users.

The Municipality reports the following major governmental funds:

General Fund: The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those that are required to be accounted in another fund.

Community Development Block Grant Program Fund (CDBG): CDBG fund is used to account for revenues sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

Commonwealth Legislature Grants Fund: This fund accounts for revenue sources from grants provided by the Commonwealth Legislature for specific purposes which includes, among others, acquisition, development and improvements of capital assets.

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

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets. The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method 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 Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when the related liability is incurred.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Property taxes are recognized as revenues in the year for which they are levied. Revenues on intergovernmental grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met and revenue becomes available. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available.

The Municipality reports deferred revenues in the governmental funds statements, which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met. (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following: 1) payments of principal and interest on general long term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) 2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Notes to Financial Statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

Required Supplementary Information:

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

3. *Cash, cash equivalents and cash with fiscal agent*

Cash and cash equivalents consist of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. The Municipality follows the practice of pooling cash of all funds except for certain state grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits.

Cash with fiscal agent in the debt service fund consists of the undisbursed balance of property tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Cash with fiscal agent of other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Governmental Development Bank of Puerto Rico or a federal government agency.

4. *Receivables and due from governmental entities*

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from Commonwealth governmental entities in the general fund represents contributions from the Puerto Rico Electric Power Authority (PREPA) for payments in lieu of tax and/or represents amounts due from the Municipal Revenues Collection Center (CRIM) for excess of actual collections over advances of property taxes and amounts of municipal equalization fund; in other governmental funds represents amounts owed to the Municipality for reimbursement of expenditures incurred on Commonwealth agencies grants (other governmental funds). Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of subsequent fiscal year.

5. *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 from/to 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 from/to other funds".

6. *Inventories*

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

7. Capital assets

Capital assets, which include property, plant, equipment, and infrastructure (e.g., roads, bridges, sidewalks, and similar items), are reported in the governmental activities column in the Statement of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The municipality maintains a threshold level of \$1,000 or more for capitalizing vehicles, machinery and equipment. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

All capital assets, other than land, are depreciated using the straight-line method over the following useful lives:

<u>Description</u>	<u>Years</u>
Land improvements	20
Buildings and building improvements	20-50
Infrastructure	10-50
Vehicles, machinery and equipment	5-20

8. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities. Bond issuance costs are reported as deferred charges and amortized as required by current standards.

In the fund financial statements, the face amount of the debt issued is reported as other financing sources. Governmental fund types recognize bond issuance costs during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

9. Compensated absences

The Municipality's employee accumulates vacation and sick leave based on continuous service. The vacation and sick leave for employees are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick pay is liquidated to employees with 10 years or more service up to the maximum number of days. The amount of vacations leave is accrued if earned

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

based on services already performed by employees and if it is probable that will be paid in a future period. The amount of sick leave is accrued based on all vesting amounts for which payment is probable and on accumulated benefits as of the fiscal year-end.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

10. Fund balance

a. Reservation of fund balance

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

- | | |
|------------------|--|
| Encumbrances: | Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received. |
| Debt Service: | Represents net assets available to finance future debt service payments. |
| Capital Projects | Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects area completed. |

b. Unreserved fund balance-designations

Designations of unreserved fund balance represent tentative plans or commitments of governmental resources.

11. Interfund transactions

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

12. *Risk financing*

The Department of the Treasury of the Commonwealth of Puerto Rico (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Hormigueros consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

13. *Use of estimates*

The preparation of the basic financial statements in accordance 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 basic financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

14. *Future adoption of accounting pronouncements*

The GASB has issued the following statements, which the Municipality has not yet adopted:

	Statement	To be Adopted in Fiscal year ended,
39	Determining Whether Certain Organizations Are Component Units - an amendment of GASB 34 Statement No. 14	June 30, 2004
40	Deposit and Investment Risk Disclosure - an amendment of GASB Statement No. 3	June 30, 2005

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

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE B - DEPOSITS

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. The Secretary of Treasury of Puerto Rico holds all securities pledged as collateral. In addition, the Municipality maintains deposits with the Governmental Development Bank of Puerto Rico (GDB). The Municipality's bank balances in commercial banks of \$7,239,202 were fully collateralized at June 30, 2003. Deposits at GDB of \$652,798, restricted principally for capital projects and \$1,055,762 that are reported in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

NOTE C - RECEIVABLES

1. Municipal license taxes

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15. During the fiscal year ended June 30, 2003 the tax rates were as follows:

Financial business - 1.50% of gross revenues
 Other organizations - .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. The Municipality recognizes tax revenue at that moment. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable representing uncollected tax as of June 30, 2003 on filed tax returns follows:

	<u>Amount</u>
Receivable as of June 30, 2003	\$ 259,663
Less: allowance for uncollectible	<u>(246,487)</u>
	<u>\$ 13,176</u>

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$1,007,754 are recorded as deferred revenues.

2. Lease

The Municipality is a lessor of a property, which consists of a building facility, classified as direct financing lease. The lease term is for twenty years under a no cancelable lease agreement. The following list the component of the net investment in direct financing lease as of June 30:

Total minimum lease payments to be received	\$ 818,634
Less: Unearned income	<u>(305,054)</u>
Net investment in direct financing lease	<u>\$ 513,580</u>

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE C - RECEIVABLES - Continued

At June 30, 2003, minimum lease payments for each of the five succeeding fiscal years are as follows:

Year	Amount
2004	\$ 76,152
2005	76,152
2006	76,152
2007	76,152
2008	76,152
2009-2014	437,874
	<u>\$ 818,634</u>

The net investment in direct financing lease in the amount of \$513,580 is recorded as deferred revenue in the governmental fund statements since it is not available as required by current standards.

3. Due from Commonwealth entities

Amounts due from Commonwealth entities as of June 30, 2003 follow:

	Amount
Municipal Revenue Collection Center (CRIM) – excess of actual property tax collections over advances of property tax and amounts of municipal equalization fund	\$ 121,759
Puerto Rico Electric Power Authority (PREPA) – settled case-see note O(3)	377,184
Puerto Rico Electric Power Authority (PREPA) – compensation in lieu of tax	79,224
Puerto Rico Department of Labor – payroll and related liabilities under Law No. 52	51,404
	<u>\$ 629,571</u>

The amounts due from CRIM and from PREPA for compensation in lieu of tax for a total amount of \$200,983 are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards.

NOTE D - INTERFUND TRANSACTIONS

1. Due from/to other funds:

Amounts due from/to other funds represent temporary advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE D - INTERFUND TRANSACTIONS - Continued

Receivable Fund	Payable Fund	Amount
General Fund	Major fund-CDBG	\$ 6,253
	Other governmental funds-Law No. 52	84,710
	Other governmental funds-others	4,813
Total:		<u>\$ 95,776</u>

2. Operating transfers:

Transfers between individual funds were made for operational purposes. Transfers includes interest earned on cash with fiscal agents in the debt service fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; and principal and interest payments of general long term debt transferred from the general fund to the debt service fund.

NOTE E - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2003 is as follows:

	Balance July 1, 2002	Increases	Decreases	Balance June 30, 2003
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 3,186,599	\$ -	\$ -	\$ 3,186,599
Construction in progress	420,344	1,050,755	286,285	1,184,814
Total capital assets not being depreciated:	3,606,943	1,050,755	286,285	4,371,413
Capital assets, being depreciated:				
Land improvements	935,819	93,813	-	1,029,632
Buildings and building improvements	14,587,747	259,239	-	14,846,986
Infrastructure	10,248,212	416,339	-	10,664,551
Vehicles, machinery and equipment	4,976,995	317,674	69,542	5,225,127
Total capital assets being depreciated	30,748,773	1,087,065	69,542	31,766,296
Less accumulated depreciation for:				
Land improvements	104,914	31,855	-	136,769
Buildings and building improvements	3,737,212	423,231	-	4,160,443
Infrastructure	1,203,469	511,939	-	1,715,408
Vehicles, machinery and equipment	2,683,017	325,507	66,016	2,942,508
Total accumulated depreciation	7,728,612	1,292,532	66,016	8,955,128
Total capital assets being depreciated, net	23,020,161	(205,467)	3,526	22,811,168
Governmental activities capital assets, net	<u>\$ 26,627,104</u>	<u>\$ 845,288</u>	<u>\$ 289,811</u>	<u>\$ 27,182,581</u>

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE E - CAPITAL ASSETS - Continued

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

Governmental activities:

General government	\$ 67,846
Public works and sanitation	686,990
Public safety	89,531
Culture and recreation	324,132
Welfare and community development	116,224
Education	<u>7,809</u>

Total depreciation expense, governmental activities	<u>\$ 1,292,532</u>
---	---------------------

NOTE F - DEFERRED REVENUES

Deferred revenues for Commonwealth agencies represent resources received before the Municipality has a legal claim to them and for federal grants represent resources received before allowable expenditures are incurred. Details of these balances follow:

Fund/Grant	Commonwealth agencies	Federal grants
Major Fund-CDBG	\$ -	\$ 1,200
Other Governmental Funds- Rural Housing Preservation Grant	-	12,513
Other Governmental Funds-Child Care and Development Block Grant	-	3,272
Other Governmental Funds-Home Auxiliary Assistance	6,297	-
Other Governmental Funds-FEMA	-	312,896
Other funds-Child and Adult Care Food Program	<u>-</u>	<u>12,033</u>
Total:	<u>\$ 6,296</u>	<u>\$ 341,914</u>

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE G - LONG TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2003:

	Balance at July 1, 2002	Increases	Decreases	Balance at June 30, 2003	Due within one year
General, Special Obligations Bonds and Notes	\$ 7,303,000	\$ -	\$ 387,000	\$ 6,916,000	\$ 391,000
Compensated absences	924,681	118,574	133,519	909,736	121,836
Claims and judgments	-	1,911,854	-	1,911,854	1,911,854
Bond anticipation note	1,040,000	-	-	1,040,000	1,040,000
Payable to CRIM-prior years doubtful accounts	158,431	-	-	158,431	114,796
	<u>\$ 9,426,112</u>	<u>\$ 2,030,428</u>	<u>\$ 520,519</u>	<u>\$ 10,936,021</u>	<u>\$ 3,579,486</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2003 amount to \$6,916,000. The Governmental Development Bank of Puerto Rico (GDB) services all these bonds, maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. The Municipality is required to maintain a legal debt margin of 10% of the total assessment of property located within the Municipality plus the balance of the property taxes in the debt service fund. Principal and interest payments of \$690,000 Revenue bonds are made from an "Interest Bearing Account" (IBA) maintained by GDB, which is financed with proceeds from lessee's rental payments. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM).

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE G - LONG TERM DEBT - Continued

A detail of the general and special obligation bonds and notes as of June 30, 2003 follows:

	<u>Outstanding Amount</u>
1994 public improvement bonds of \$85,000 due in annual installments of \$5,000 to \$10,000 through July 1, 2008; bearing interest at rates ranging from 5% to 7.606%	\$ 35,000
1997 general obligation bonds of \$108,000 due in annual installments of \$13,000 to \$18,000 through January 1, 2004; with interest at 4.875%	18,000
1994 public improvement bonds of \$125,000 due in annual installments of \$3,000 to \$10,000 through January 1, 2019; with interest at 5%	101,000
1992 public improvement bonds of \$168,000 due in annual installments of \$2,000 to \$17,000 through January 1, 2017; with interest at 5%	135,000
1997 general obligation bonds of \$175,000 due in annual installments of \$5,000 to 15,000 through July 1, 2021; bearing interest at rates ranging from 4.865% to 6.75%	140,000
1983 public improvement bonds of 251,000 due in annual installments of \$5,000 to \$17,000 through January 1, 2008; with interest at 5%	77,000
1998 general obligation notes of \$320,700 due in annual installments of \$38,700 to 54,000 through January 1, 2005; with interest at 4.75%	104,000
1996 general obligation bonds of \$390,000 due in annual installments of \$5,000 to \$40,000 through July 1, 2020; bearing interest at rates ranging from 4.70% to 6.63%	340,000
1999 general obligation bonds of \$410,000 due in annual installments of \$5,000 to \$35,000 through July 1, 2024; bearing interest at rates ranging from 2.70% to 7.81%	385,000
2001 general obligation bonds of \$425,000 due in annual installments of \$5,000 to \$40,000 through July 1, 2025; bearing interest at rates ranging from 2.70% to 6.13%	410,000

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE G - LONG TERM DEBT - Continued

	<u>Outstanding Amount</u>
1999 general obligation notes of \$705,000 due in annual installments of \$80,000 to \$125,000 through July 1, 2006; bearing interest at rates ranging from 5% to 7.81%	345,000
1999 general obligation bonds of \$736,000 due in annual installments of \$19,000 to \$52,000 through January 1, 2024; with interest at 4.75%	717,000
1998 general obligation bonds of \$983,000 due in annual installments of \$23,000 to \$65,000 through January 1, 2024; with interest at 4.5%	910,000
1997 general obligation bonds of \$1,538,000 due in annual installments of \$41,000 to \$109,000 through January 1, 2022; with interest at 4.75%	1,409,000
1992 revenue bonds of \$690,000 due in annual installments of \$10,000 to \$50,000 through July 1, 2013; with interest at 9%	420,000
2002 special obligation bonds of \$1,410,000 due in annual installments of \$20,000 to 125,000 through July 1, 2026; bearing interest at rates ranging from 5% to 7.5%	<u>1,370,000</u>
	<u>\$ 6,916,000</u>

The annual requirements to amortize general and special obligation bonds and notes as of June 30, 2003 follow:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 391,000	\$ 387,334
2005	399,000	376,024
2006	365,000	352,198
2007	257,000	329,542
2008	263,000	314,545
2009-2013	1,397,000	1,342,007
2014-2018	1,559,000	928,851
2019-2023	1,723,000	410,423
2023-2026	<u>562,000</u>	<u>118,250</u>
Totals	<u>\$ 6,916,000</u>	<u>\$ 4,559,174</u>

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE G - LONG TERM DEBT - Continued

3. *Other long-term liabilities*

	<u>Amount</u>
Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds	\$ 909,736
Claims and judgments - represent the final settlement of three legal cases paid subsequent to June 30, 2003. In one of the cases, the awarded amount of \$1,850,000 was subsequently refinanced through an operational loan to be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). The remaining amount pertaining to the other cases were paid with other unrestricted funds.	1,911,854
Bond anticipation note (BAN) - the Municipality intends refinancing of the BAN's on a long-term basis. It has demonstrated its intention and its ability to consummate by a financing agreement with the Governmental Development Bank of Puerto Rico (GDB) which does not expire within one year from the date of the Statement of Net Assets. The Municipality refinanced total debt on July 10, 2003 with a \$1,040,000 general obligation bond issuance through GDB.	1,040,000
Payable to CRIM-prior year's doubtful accounts - As of June 30, 2002 the Municipality has entered into an agreement with the Municipal Revenue Collection Center (CRIM) to refinance the prior year's property tax doubtful accounts, which amounted to \$158,431 on a long-term basis under the provision of Law No. 146 of October 11, 2001. The refinancing was done through a special loan to be repaid from .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. The Municipal Legislature of Hormigueros on Resolution No. 40 of March 18, 2002 authorized the financing agreement.	158,431

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE H - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

The Municipality operates a landfill since 1983. Commonwealth and Federal laws and regulations require the Municipality to place a final cover on its landfill when it stops accepting waste and perform certain maintenance and monitoring functions at the landfill site for thirty years after closure. In addition to operating expenses related to current activities of the landfill, an expense provision and related liability should be recognized based on the future closure and post closure care costs that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post closure care costs is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post closure care costs has not been determined and accounted as of June 30, 2003.

NOTE I - PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) (a state governmental agency) is responsible for the assessment, collection and distribution of real and personal property taxes in accordance with the Municipal Property Tax Law (Law 83 of August, 1995). The Municipal Government based on limits established by the Commonwealth Legislature determines the tax levied on property. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed, with the CRIM by May 15 of each year. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a receivable of \$121,759 resulting from the final settlement for fiscal year 2002-2003. The amount is recorded as revenue in the government-wide statements but is recorded as a deferred revenue in the governmental funds statements since is not available as required by current standards.

NOTE J - INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

	<u>Amount</u>
Amount of municipal equalization fund send by CRIM	\$ 1,977,540
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	963,413
Reimbursement from Commonwealth Government of Christmas Bonus expense	87,667
	<u>\$ 3,028,620</u>

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE K - FUND BALANCE RESTATEMENTS

Beginning fund balances of governmental funds has been restated to reflect the correction of errors and recognition of certain assets and liabilities not recorded in previous year. Detail of restatements follows:

	General Fund	Community Development Block Grant Program	Commonwealth Legislature Grants	Debt Service Fund	Other Governmental Funds
Fund balance at beginning of year, as previously reported:	\$ 1,792,560	\$ (4,600)	\$ 824,030	\$ 589,046	\$ 1,900,786
Adjustments:	<u>21,574</u>	<u>11,068</u>	<u>39,467</u>	<u>7,357</u>	<u>(421,419)</u>
Fund balance at end of year, as restated	<u>\$ 1,814,134</u>	<u>\$ 6,468</u>	<u>\$ 863,497</u>	<u>\$ 596,403</u>	<u>\$ 1,479,367</u>

NOTE L - RETIREMENT PLAN

1. Plan description

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death and disability benefits.

Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and nonoccupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Law No. 305 of September 24, 1999 amended the Act No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE L - RETIREMENT PLAN - Continued

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. 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 up 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 a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.275% of gross salary.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

<u>Fiscal year ended:</u>	<u>Law No. 447</u>	<u>System 2000</u>
2003	<u>\$ 182,597</u>	<u>\$ 37,729</u>
2002	<u>\$ 203,506</u>	<u>\$ 17,253</u>
2001	<u>\$ 224,505</u>	<u>N/A</u>

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE M - COMMITMENTS

1. *Operating leases*

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted approximately \$ 6,798. Management believes that the summary of the future minimum rental commitments under no cancelable equipment leases with terms exceeding one year is not significant.

2. *Construction*

The Municipality has commitments at June 30, 2003 of approximately \$ 403,960 for construction, improvements or renovation of certain municipal facilities.

NOTE N - CONTINGENCIES

1. *Federal and State grants*

Projects financed by Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. *Litigations*

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. As a result of three settled cases subsequent to June 30, 2003 and not to be covered by insurance, the Municipality accrued \$1,911,854 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

Municipality of Hormigueros

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE O - SUBSEQUENT EVENTS

1. As of June 30, 2003 the Municipality recorded in the Government-Wide statements a liability of \$1,850,000 for a legal case which judgment is dated November 29, 2001 but finally settled on July 2003. The Municipality refinanced this debt on a long-term basis through a non-interest bearing operational loan from the Puerto Rico Department of Treasury issued on October 14, 2003. This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).
2. On July 10, 2003 the bond anticipation note of \$1,040,000 have been refinanced with a general obligation bond issuance through GDB, payable in annual installments of \$27,000 to \$76,000 through January 1, 2025; with interest at 5.125%
3. On July 10, 2003 the Municipality received \$377,184 from the Puerto Rico Electric Power Authority (PREPA) related to a settled legal case against PREPA by the Municipality's of Puerto Rico.

REQUIRED SUPPLEMENTARY INFORMATION

MUNICIPALITY OF HORMIGUEROS
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2003

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues				
Property taxes	\$ 2,280,152	\$ 2,495,550	\$ 2,528,129	\$ 32,579
Municipal license taxes	1,270,000	1,270,000	1,107,525	(162,475)
Intergovernmental	2,428,385	2,428,385	3,028,620	600,235
Fees, fines and charges for services	538,000	842,000	1,279,289	437,289
Interest	95,000	95,000	105,396	10,396
Other	45,000	45,000	99,170	54,170
Transfers from other funds	-	-	-	-
Total revenues	<u>6,656,537</u>	<u>7,175,935</u>	<u>8,148,129</u>	<u>972,194</u>
Expenditures				
General government	2,932,329	3,718,632	3,802,839	(84,207)
Public works and sanitation	1,586,129	1,726,785	1,693,905	32,880
Public safety	618,627	569,578	565,309	4,269
Culture and recreation	482,513	463,096	443,885	19,211
Health	353,348	353,348	352,184	1,164
Welfare and community development	539,441	450,346	418,208	32,138
Education	19,900	19,900	18,559	1,341
Transfers to other funds	124,250	124,250	89,500	34,750
Total expenditures	<u>6,656,537</u>	<u>7,425,935</u>	<u>7,384,389</u>	<u>41,546</u>
Excess (deficiency) of revenues over expenditures	-	(250,000)	763,740	1,013,740
Fund Balance Allocation (Note B)	-	250,000	-	(250,000)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 763,740</u>	<u>\$ 763,740</u>

The accompanying notes to required supplemental information are an integral part of this schedule.

Municipality of Hormigueros

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND**

June 30, 2003

NOTE A - BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for General Fund following the requirements of the Municipal Law of 1981 as amended. Although all operating expenses and expenditures are allocated to departmental operating budgets, certain items are not considered to be subject to direct control at the department level. These includes: terminal leave payments, payroll taxes, pension costs, court costs and settlements, telephone and electricity expenses and liability, workers compensation and property insurance premiums. The Municipal Legislature approves budget amendments, which require a change in total appropriations of any department. Certain budget transfers within the limitations and restriction of the Municipal Law can be approved by the Executive Branch or by the Legislature Branch. The budget is prepared on a budgetary (statutory) basis of accounting, which is different from GAAP. Revenues include amounts classified by GAAP as other financing sources and expenditures include encumbrances and amounts classified by GAAP as other financing uses. On a GAAP basis, encumbrances outstanding at year-end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year end.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - FUND BALANCE ALLOCATION

The budgetary comparison schedule – general fund present a fund balance allocation of \$250,000. This represents a readjustment of current year budget with prior year's budgetary surpluses, approved by Resolution Number 22 of February 6, 2003 of the Municipal Legislature.

NOTE C - BUDGET TO GAAP RECONCILIATION

The budgetary comparison schedule - general fund presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

Municipality of Hormigueros

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

June 30, 2003

NOTE -B BUDGET TO GAAP RECONCILIATION - Continued

Revenues:

Actual amounts (budgetary basis) revenues from the budgetary comparison schedule:	\$ 8,148,129
Differences - budget to GAAP:	
Transfers from other funds are revenues for budgetary basis but are not revenues for financial reporting purposes:	(25,298)
Municipal license taxes receivable at year-end are not revenues for budgetary basis but are considered revenues of fiscal year 2002-2003 for financial reporting purposes:	<u>13,176</u>
Total revenues as reported on the Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds:	<u>\$ 8,136,008</u>

Expenditures:

Actual amounts (budgetary basis) "expenditures" from the budgetary comparison schedule:	\$ 7,384,389
Differences - budget to GAAP:	
Transfers to other funds are expenditures for budgetary basis but are not expenditures for financial reporting purposes:	(89,500)
Budgeted expenditures not considered for financial reporting purposes	(5,526)
Non budgeted items recorded as current year expenditures for financial reporting purposes:	3,952
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	<u>(245,379)</u>
Total expenditures as reported on the Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds:	<u>\$ 7,047,936</u>

MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FISCAL YEAR ENDED JUNE 30, 2003

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Grantor's Number (note C)	Expenditures (note A)
<u>U.S. Department of H.U.D.</u>			
Major Programs:			
Passed through the Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - State's Program	14.228	FD - 30 AF - 30 AB - 30 CD - 30	\$ 546,885
Direct Program:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	438,199
<u>U.S. Department of Agriculture</u>			
Non-Major Programs:			
Direct Program:			
Water and Waste Disposal System for Rural Communities	10.760	N/A	23,567
Non-Major Programs:			
Direct Program:			
Rural Housing Preservation Grant	10.433	N/A	30,392
Passed through the P.R. Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	8,275
<u>U.S. Department of Health and Human Services</u>			
Non-Major Program:			
Passed through the P.R. Department of Family - Families and Children Administration:			
Child Care and Development Block Grant	93.575	N/AV	156,620
<u>U.S. Department of Justice</u>			
Non-Major Program:			
Passed through the P.R. Department of Justice:			
Local Law Enforcement Block Grant	16.592	N/AV	60,003
Bullet Vest Partnership Program	16.607	N/AV	3,795
<u>U.S. Department of Transportation</u>			
Non-Major Program:			
Direct Program:			
Federal Transit Formula Grants	20.507	N/A	13,763
<u>Federal Emergency Management Agency</u>			
Non-Major Program:			
Passed through the Puerto Rico Governor Office (Governor's Authorized Representative-GAR)			
Public Assistance Grants	83.544	DR-PR-1247	22,555
			\$ 1,304,054

The accompanying notes are an integral part of this schedule.

Municipality of Hormigueros

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Government and Nonprofit Organizations.

NOTE B - FEDERAL CFDA NUMBER

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

NOTE C - PASS -THROUGH GRANTOR'S NUMBER

The Municipality should treat state or local government redistributions of federal awards to the Municipality, known as "pass-through awards", as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for federal awards received as a sub recipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. Box 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

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

Mayor and Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

We have audited the basic financial statements of the Municipality of Hormigueros as of and for the year ended June 30, 2003, and have issued our report thereon date January 14, 2004, in which we have expressed a qualified opinion since the Municipality has not determined and recorded an estimate for the total municipal solid waste landfill closure and post closure care costs as required by U.S. generally accepted accounting principles. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 Hormigueros' 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 on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. However, we noted certain immaterial instances of noncompliance that we have reported to the management of the Municipality of Hormigueros in a separate letter dated January 14, 2004.

Internal Control Over Financial Reporting

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

Our consideration of the internal control over financial reporting 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 does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses. We noted other matters involving the internal control over financial reporting that we have reported to management of the Municipality of Hormigueros in a separate letter dated January 14, 2004.

This report is intended for the information of the audit committee, management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



San Juan, Puerto Rico
January 14, 2004

Stamp 1933757 was affixed
to the original.

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. BOX 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

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

Mayor and Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Hormigueros 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 program for the year ended June 30, 2003. The Municipality of Hormigueros' major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality of Hormigueros' management. Our responsibility is to express an opinion on the Municipality of Hormigueros' compliance based on our audit.

We conducted our audit of compliance in accordance with U.S. generally accepted auditing standards; 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 the Municipality of Hormigueros' 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 the Municipality of Hormigueros' compliance with those requirements.

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

We noted certain immaterial instances of noncompliance that we have reported to the management of the Municipality of Hormigueros in a separate letter dated January 14, 2004.

Internal Control Over Compliance

The management of the Municipality of Hormigueros is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality of Hormigueros' 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 does not reduce to a relative 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 operations that we consider to be material weaknesses.

This report is intended for the information of the audit committee, management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



San Juan, Puerto Rico
January 14, 2004

Stamp 1933758 was affixed
to the original.

Municipality of Hormigueros

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year ended June 30, 2003

I. Summary of audit results:

Part I - Financial Statements

1. Type of audit report: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
2. Reportable conditions reported: Yes No
3. Reportable conditions reported as a material weakness: Yes No
4. Material noncompliance disclosed: Yes No

Part II - Federal Awards

1. Reportable conditions reported: Yes No
2. Reportable conditions reported as a material weakness: Yes No
3. Type of report on compliance on major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Audit findings required to be reported under Section 510(a) of Circular A-133: Yes No

5. Major programs:

CFDA Number(s)	Name of Federal Program or Cluster
14.228	Community Development Block Grant - State's Program
14.855	Section 8 Rental Voucher Program

6. Dollar threshold used to distinguish Type A and Type B programs: \$300,000 \$3,000,000
 \$30,000,000
7. Low-risk auditee: Yes No