

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

**MUNICIPIO DE HUMACAO**  
**AUDITORIA 2001-02**  
**30 DE JUNIO DE 2002**

OFIC. DEL COMISIONADO  
DE ASUNTOS FINANCIEROS

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO**

**INDEPENDENT AUDITORS' REPORTS ON  
GENERAL-PURPOSE COMBINED FINANCIAL STATEMENTS**

**JUNE 30, 2002**

**(WITH THE ADDITIONAL REPORTS AND INFORMATION  
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS  
AND OMB CIRCULAR A-133)**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO  
**INDEPENDENT AUDITORS' REPORTS ON  
GENERAL-PURPOSE COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2002**  
(WITH THE ADDITIONAL REPORTS AND INFORMATION  
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS  
AND THE OMB CIRCULAR A-133)

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**PART I**  
**FINANCIAL**



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**INDEPENDENT AUDITORS' REPORT**

**To the Honorable Mayor and  
Member of the Municipal Legislature  
Municipality of Humacao, Puerto Rico**

We have audited the accompanying general-purpose financial statements of the **Municipality of Humacao, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2002, as listed in the Table of Contents. These general-purpose financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit.

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

The **Municipality** has not maintained a complete and accurate inventory of property, plant and equipment purchased in prior years to June 30, 2002. We were, therefore, unable to apply generally accepted auditing procedures to an examination of the costs of assets included in the General Fixed Assets Account Group.

In our opinion, except for the effect of such adjustment, if any, as might have determined to be necessary had we been able to audit the fixed assets of the general fixed assets account group as described in the preceding paragraph, the general-purpose combined financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the **Municipality**, as of June 30, 2002, and the results of operations and changes in the fund balances for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 26, 2002 on our consideration of the **Municipality's** internal control structure 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.

**INDEPENDENT AUDITORS' REPORT**

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Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole.

  
CPA DIAZ-MARTINEZ, PSC  
Certified Public Accountants

Caguas, Puerto Rico  
November 26, 2002



MUNICIPALITY OF HUMACAO, PUERTO RICO

COMBINED BALANCE SHEET -  
ALL FUND TYPES AND ACCOUNT GROUPS

JUNE 30, 2002

	GOVERNMENTAL FUND TYPES				ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)
	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	DEBT SERVICE	GENERAL FIXED ASSETS	GENERAL LONG-TERM DEBT	
<b>ASSETS AND OTHER DEBITS:</b>							
Cash and Investments (Note 1 E and 2) .....	\$ 22,718,162	\$ 4,570,899	\$ 30,576	\$ -	\$ -	\$ -	\$ 27,319,637
Cash with Fiscal Agent (Note 1 E) .....	214,594	2,694,496	627,279	4,730,959	-	-	8,267,328
Receivables:							
Property Taxes (Note 8) .....	-	-	-	59,717	-	-	59,717
Federal Grants (Note 10) .....	-	267,950	-	-	-	-	267,950
Others Funds (Note 3) .....	7,122	366,025	3,031,254	-	-	-	3,404,401
Others .....	-	108,103	-	-	-	-	108,103
Property, Plant and Equipment (Note 1 G) .....	-	-	-	-	40,252,008	-	40,252,008
Amount Available in Debt Service Fund (Note 7) .....	-	-	-	-	-	4,783,554	4,783,554
Amount to be Provide for Payment of:							
General Long-Term Debt (Note 6) .....	-	-	-	-	-	15,687,729	15,687,729
Advance Property Taxes (Note 6) .....	-	-	-	-	-	492,779	492,779
State Health Insurance Plan Debt (Note 6) .....	-	-	-	-	-	1,120,397	1,120,397
Vested Compensated Absence (Note 1 I) .....	-	-	-	-	-	2,750,987	2,750,987
<b>TOTAL ASSETS AND OTHER DEBITS .....</b>	<b>\$ 22,939,878</b>	<b>\$ 8,007,473</b>	<b>\$ 3,689,109</b>	<b>\$ 4,790,676</b>	<b>\$ 40,252,008</b>	<b>\$ 24,835,446</b>	<b>\$104,514,590</b>

continue

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**COMBINED BALANCE SHEET –  
ALL FUND TYPES AND ACCOUNT GROUPS**

**JUNE 30, 2002**

	GOVERNMENTAL FUND TYPES				ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)
	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	DEBT SERVICE	GENERAL FIXED ASSETS	GENERAL LONG-TERM DEBT	
<b>LIABILITIES AND FUND EQUITY</b>							
<b>LIABILITIES:</b>							
Accounts Payable and Accrued Liabilities .....	\$ 623,207	\$ 717,600	\$ -	\$ -	\$ -	\$ -	\$ 1,340,807
Due to:							
Government Units (Note 4) .....	219,871	-	-	-	-	-	219,871
Other Funds (Note 3) .....	3,397,279	-	-	7,122	-	-	3,404,401
Deferred Revenues:							
Volume of Business Tax (Note 9) .....	6,144,540	-	-	-	-	-	6,144,540
Federal Grants (Note 10) .....	-	1,033,981	3,101	-	-	-	1,037,082
Long-Term Debts:							
General Obligations Bonds (Note 6) .....	-	-	-	-	-	13,193,000	13,193,000
Special Obligations Notes (Note 6) .....	-	-	-	-	-	7,278,283	7,278,283
Advance Property Taxes (Note 6) .....	-	-	-	-	-	492,779	492,779
State Health Insurance Plan (Note 6) .....	-	-	-	-	-	1,120,397	1,120,397
Vested Compensated Absence (Note 1 l) .....	-	-	-	-	-	2,750,987	2,750,987
<b>TOTAL LIABILITIES</b> .....	<u>10,384,897</u>	<u>1,751,581</u>	<u>3,101</u>	<u>7,122</u>	<u>-</u>	<u>24,835,446</u>	<u>36,982,147</u>

continue

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**COMBINED BALANCE SHEET –  
ALL FUND TYPES AND ACCOUNT GROUPS**

**JUNE 30, 2002**

	GOVERNMENTAL FUND TYPES				ACCOUNT GROUPS		TOTALS (MEMORANDUM ONLY)
	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	DEBT SERVICE	GENERAL FIXED ASSETS	GENERAL LONG-TERM DEBT	
<b>FUND EQUITY:</b>							
Investment in Property, Plant and Equipment (Note 1 G) .....	\$ -	\$ -	\$ -	\$ -	\$ 40,252,008	\$ -	\$ 40,252,008
Fund Balance:							
Reserved for Encumbrances (Note 1 K) .....	1,402,888	-	-	-	-	-	1,402,888
Unreserved:							
Designated for Debt Service (Note 1 K) .....	-	-	-	4,783,554	-	-	4,783,554
Designated for Subsequent Year Expenditures	-	6,255,892	3,686,008	-	-	-	9,941,900
Undesignated .....	11,152,093	-	-	-	-	-	11,152,093
<b>TOTAL FUND EQUITY .....</b>	<b>12,554,981</b>	<b>6,255,892</b>	<b>3,686,008</b>	<b>4,783,554</b>	<b>40,252,008</b>	<b>-</b>	<b>67,532,443</b>
<b>TOTAL LIABILITIES AND FUND EQUITY .....</b>	<b>\$ 22,939,878</b>	<b>\$ 8,007,473</b>	<b>\$ 3,689,109</b>	<b>\$ 4,790,676</b>	<b>\$ 40,252,008</b>	<b>\$ 24,835,446</b>	<b>\$104,514,590</b>

The accompanying notes to general-purpose financial statements are an integral part of this statement.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES  
IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

	GOVERNMENTAL FUND TYPES				TOTALS (MEMORANDUM ONLY)
	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	DEBT SERVICE	
<b>REVENUES</b>					
Property Taxes (Note 8).....	\$ 10,108,479	\$ -	\$ -	\$ 2,853,543	\$ 12,962,022
Volume of Business Taxes (Note 9).....	8,084,047	-	-	-	8,084,047
Federal Assistance (Note 10).....	-	10,546,821	335,082	-	10,881,903
Intergovernmental (Note 10).....	3,919,745	2,774,121	311,379	-	7,005,245
Licenses and Permits.....	2,490,226	-	-	-	2,490,226
Miscellaneous.....	1,427,471	-	-	-	1,427,471
<b>TOTAL REVENUES</b> .....	<b>26,029,968</b>	<b>13,320,942</b>	<b>646,461</b>	<b>2,853,543</b>	<b>42,850,914</b>
<b>EXPENDITURES</b>					
<b>Current:</b>					
Mayor and Municipal Legislature .....	2,135,563	-	-	-	2,135,563
General Government.....	10,097,264	2,902,348	855	-	13,000,467
Public Safety .....	1,321,348	-	-	-	1,321,348
Public Works .....	4,240,822	-	-	-	4,240,822
Culture and Recreation .....	1,212,139	-	-	-	1,212,139
Sanitation .....	916,489	-	-	-	916,489
Solid Waste Disposal .....	-	65,056	-	-	65,056
Human Services and Welfare .....	3,208,255	9,254,523	-	-	12,462,778
Urban Development .....	-	320,877	3,731,274	-	4,052,151
Capital Outlays.....	426,378	607	-	-	426,985
Amortization of Property Taxes Advances .....	7,406,094	-	-	-	7,406,094
<b>Debt Service:</b>					
Principal Retirement (Notes 6 and 7).....	-	-	-	1,735,873	1,735,873
Interest Payment .....	-	-	-	1,242,862	1,242,862
<b>TOTAL EXPENDITURES</b> .....	<b>30,964,352</b>	<b>12,543,411</b>	<b>3,732,129</b>	<b>2,978,735</b>	<b>50,218,627</b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES.....</b>	<b>(4,934,384)</b>	<b>777,531</b>	<b>(3,085,668)</b>	<b>(125,192)</b>	<b>(7,367,713)</b>

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES  
IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

	GOVERNMENTAL FUND TYPES				TOTALS (MEMORANDUM ONLY)
	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	DEBT SERVICE	
<b>OTHER FINANCIAL SOURCES (USES):</b>					
Advances of Property Taxes (Note 8) .....	\$ 7,406,094	\$ -	\$ -	\$ -	\$ 7,406,094
Proceed of Note .....	1,950,000	-	-	-	1,950,000
Operating Transfer In .....	-	1,950,000	-	359,857	2,309,857
Operating Transfer Out .....	<u>(2,309,857)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,309,857)</u>
<b>TOTAL OTHER FINANCING SOURCES (USES) .....</b>	<u>7,046,237</u>	<u>1,950,000</u>	<u>-</u>	<u>359,857</u>	<u>9,356,094</u>
Excess (Deficiency) of Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Sources .....	2,111,853	2,727,531	(3,085,668)	234,665	1,988,381
Fund Balances at Beginning of Year .....	7,193,416	3,528,362	6,771,676	7,798,602	25,292,056
Residual Equity Transfer (Note 1 K) .....	<u>3,249,713</u>	<u>-</u>	<u>-</u>	<u>(3,249,713)</u>	<u>-</u>
<b>FUND BALANCES AT END OF YEAR .....</b>	<u>\$ 12,554,982</u>	<u>\$ 6,255,893</u>	<u>\$ 3,686,008</u>	<u>\$ 4,783,554</u>	<u>\$ 27,280,437</u>

The accompanying notes to general-purpose financial statements are an integral part of this statement.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**COMBINED STATEMENT OF REVENUES, EXPENDITURES AND ENCUMBRANCES AND CHANGES IN FUND BALANCE – BUDGET AND ACTUAL – GENERAL AND DEBT SERVICE FUNDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

	GENERAL			DEBT SERVICE		
	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAVORABLE)	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAVORABLE)
<b>REVENUES</b>						
Property Taxes Advances .....	\$ 9,145,359	\$ 9,179,849	\$ 34,490	\$ 2,875,944	\$ 2,853,543	(\$ 22,401)
Volume of Business Taxes .....	7,609,706	8,084,047	474,341	-	-	-
Intergovernmental .....	3,778,451	3,919,745	141,294	-	-	-
Licenses and Permits .....	2,375,956	2,490,226	114,270	-	-	-
Miscellaneous .....	1,432,531	1,420,349	(12,182)	-	-	-
<b>TOTAL REVENUES .....</b>	<b>24,342,003</b>	<b>25,094,216</b>	<b>752,213</b>	<b>2,875,944</b>	<b>2,853,543</b>	<b>(22,401)</b>
<b>EXPENDITURES AND ENCUMBRANCES</b>						
Mayor and Municipal Legislature .....	2,494,855	2,451,796	43,059	-	-	-
General Government:						
Finance .....	9,429,345	8,848,390	580,955	-	-	-
Personnel .....	384,770	329,210	55,560	-	-	-
Insurance .....	273,841	273,841	-	-	-	-
Public Safety .....	1,516,045	1,359,347	156,698	-	-	-
Public Works .....	4,500,615	4,408,066	92,549	-	-	-
Culture and Recreation .....	1,399,073	1,261,418	137,655	-	-	-
Sanitation .....	3,549,633	3,336,032	213,601	-	-	-
Human Services and Welfare .....	1,373,967	1,318,094	55,873	-	-	-
Urban Development .....	-	-	-	-	-	-
Capital Outlays .....	554,940	426,378	128,562	-	-	-
Debt Services .....	-	-	-	2,790,956	2,978,735	(187,779)
<b>TOTAL EXPENDITURES AND ENCUMBRANCES .....</b>	<b>25,477,084</b>	<b>24,012,572</b>	<b>1,464,512</b>	<b>2,790,956</b>	<b>2,978,735</b>	<b>(187,779)</b>
<b>EXCESS OF REVENUES Over (Under)</b>						
Expenditures and Encumbrances .....	(1,135,081)	1,081,644	2,216,725	84,988	(125,192)	(210,180)

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**COMBINED STATEMENT OF REVENUES, EXPENDITURES AND  
ENCUMBRANCES AND CHANGES IN FUND BALANCE – BUDGET  
AND ACTUAL – GENERAL AND DEBT SERVICE FUNDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

	GENERAL			DEBT SERVICE		
	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAVORABLE)	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAVORABLE)
<b>OTHER FINANCIAL SOURCES (USES):</b>						
Allocation of Prior Year Fund Balance .....	\$ 2,914,156	\$ -	(\$ 2,914,156)	\$ -	\$ -	\$ -
Operating Transfer In (Out).....	<u>(1,779,075)</u>	<u>(359,857)</u>	<u>1,419,218</u>	<u>-</u>	<u>359,857</u>	<u>359,857</u>
TOTAL OTHER FINANCIAL SOURCES (USES).....	<u>1,135,081</u>	<u>(359,857)</u>	<u>(1,494,938)</u>	<u>-</u>	<u>359,857</u>	<u>359,857</u>
Excess of Revenues and Other Sources (Uses) Over Expenditures and Other Uses ....	<u>\$ -</u>	721,787	<u>\$ 721,787</u>	<u>\$ 84,988</u>	234,665	<u>\$ 149,677</u>
Adjustment Required Under Generally Accepted Accounting Principles:						
Net Change in Encumbrance .....		455,022			-	
Proceed of Bonds .....		1,950,000			-	
GAAP Adjustment to Revenues .....		7,122			-	
Accrual Liability for Certain Debts Not Recognized in Budget .....		(708)			-	
Change in Non Budget Items .....		(1,021,370)			-	
Fund Balance at Beginning of Year .....		7,193,416			7,798,602	
Residual Equity Transfer (Note 1 K) .....		<u>3,249,713</u>			<u>(3,249,713)</u>	
<b>FUND BALANCE AT END OF YEAR.....</b>		<b><u>\$ 12,554,982</u></b>			<b><u>\$ 4,783,554</u></b>	

The accompanying notes to general-purpose financial statements are an integral part of this statement.

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSES FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Humacao, Puerto Rico (Municipality)** was founded in the year 1793, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 legislators also elected in the general elections of Puerto Rico for a four-year period.

The **Municipality** provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the **Municipality** conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant of such policies.

#### A. Financial Reporting Entity

The general-purpose financial statements of the **Municipality** have been prepared in accordance with accounting principles general accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is a standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

The general-purpose financial statements present the financial position of the various fund types and accounts groups and the results of operations of the various fund types of the **Municipality**. This includes the organizations units governed by the Executive Officers and members of the Municipal Legislature of the **Municipality**. In evaluating the **Municipality** as a reporting entity, management has considered all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of **GASB Number 14**.

The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government.

A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete.

The relative importance of each criteria must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the **Municipality** indicates that the reporting entity consists of all funds and accounts groups included in the combined balance sheet, therefore, no organizations, activities or functions are required to be included in the reporting entity.

#### B. Basis of Presentation

The accounts of the **Municipality** are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set off self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. The various funds and account groups are summarized by type in the accompanying general-purpose financial statements. The **Municipality** records its transactions in the fund types and account groups described below. Transactions between funds within a fund type, if any, have been eliminated.

Amounts in the "Totals Memorandum Only" column in the combined financial statements represent a summation of the combined financial statements line items of the fund types and account groups, and are presented for the analytical purposes only. The summation include fund types and account groups that use different basis of accounting includes interfund transactions that have not been eliminated and the caption "amounts to be provided", which is not an asset in the usual sense. Consequently, amounts shown in the "Totals Memorandum Only" column are not comparable to a consolidation and do not represent the total resources available or total revenues and expenditures of the **Municipality**.

#### GOVERNMENTAL FUNDS

Governmental funds are those through which most governmental functions of the **Municipality** are financed. The acquisition, use, and balances of the **Municipality's** expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than upon net income. The following are the **Municipality's** governmental fund types:

**General Fund** – This is the general operating fund of the **Municipality**. It is used to account for all financial resources, except those required to be accounted for in another fund.

continue

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

#### B. Basis of Presentation (continuation)

Special Revenue Fund – This is used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specific purposes.

Debt Service Fund – This is used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interests and related costs.

Capital Projects Fund – This is used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by Special Revenue Fund). Completed assets if a stewardship nature is transferred to the General Fixed Assets Account Group.

#### ACCOUNT GROUPS

Account groups is not fund; it does not reflect available financial resources and related liabilities, but is accounting record for the general long-term obligations. Account groups are used to establish accounting control and accountability for the Municipality's general fixed assets and the unmatured principal of its general long-term debts and other long-term obligations. The following is a description of the Account Group of the Municipality:

General Fixed Assets Account Group – This account group is used to account for all general fixed assets of the Municipality.

General Long-Term Debt Account Group – This account group is used to account for all long-term debt including bonds, notes and other long-term liabilities of the governmental fund type of the Municipality.

#### C. Basis of Accounting

Basis of accounting refers to the point at which revenues and expenditures are recognized in the accounts and reported in the general-purpose financial statements. It relates to the timing of the measurements made, regardless of the measurement focus applied. Governmental fund types follow the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual, i.e., both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty days, to be used to pay liabilities of the current period. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the years to which they apply.

In applying the "susceptible to accrual" concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially three types of these revenues. For one type, moneys must be expended on the specific purpose or project before any amounts will be paid to the Municipality; therefore, revenues are recognized based upon the expenditures recorded.

For the second type, moneys are received in advance and recorded as deferred revenues until the appropriate expenditures are made at which time the revenues are recorded.

For the third type, revenues are virtually unrestricted as to purpose of expenditure and nearly irrevocable or revocable only for failure to comply with the prescribed requirements, such as equal employment opportunity provisions. These resources are reflected as revenues at the time of receipt or earlier if they meet the "available" criteria.

Property taxes are recognized as revenues when collected by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico, even though a portion of the taxes may be collected in subsequent years. Licenses and permits, fines and forfeits, and miscellaneous revenues are recorded as revenues when collected, because they are generally not measurable until actually received.

Expenditures and related liabilities are generally recorded in the accounting period in which the liability is incurred. Exceptions to this general rule include: (1) vacation, sick leave, disallowance, and litigation are recorded in the General Long-Term Debt Account Group; (2) expenditures and related liabilities for principal and interest on long-term obligations, which are recorded when due; (3) landfill obligation is included in the General Long-Term Debt Account Group since it will not be funded with available expendable financial resources.

#### D. Budgetary Accounting

The Municipality's Annual Budget is prepared on the budgetary basis of accounting and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior the beginning of the fiscal year. Budgetary control is maintained at the department level for each individual appropriation. Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year.

The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the general-purpose financial statements:

1. Prior of May 31 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.

continue

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

#### D. Budgetary Accounting (continuation)

2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 1, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the general-purpose financial statements.
6. Budgetary data for the Special Revenue Fund has not been presented in the accompanying combined financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Combined Financial Statement of Revenues, Expenditures and Encumbrances, and Changes in Fund Balance – Budget and Actual, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP (See Note 8).
3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.

5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary basis.

The special funds of the Special Revenue Fund have not been included in the budget and actual comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the capital projects and special revenue funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget and actual for such programs.

#### E. Cash and Investment

The Director of Finance of the **Municipality** is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the **Municipality** and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico.

Cash balance recognized in the Debt Service Fund is restricted for the payment of the **Municipality's** obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the **Municipality's** bonds and notes issued in accordance with the law.

#### F. Receivable

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the **Municipality** for reimbursement of expenditures incurred pursuant to federally funded programs.

continue

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

#### G. Inventories

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the general-purpose financial statements.

#### H. General Fixed Assets

The General Fixed Assets Account Group reflects the cost of fixed assets of a stewardship nature (certain land, buildings, certain improvements other than building, furniture and fixtures, equipment and motor vehicles acquired or constructed by the **Municipality**. Public domain (infrastructure) fixed assets consisting of roads, bridges, underground water and sewer facilities and certain other property are recorded as expenditures and are not capitalized in the General Fixed Assets Account Group. Donated fixed assets are valued at their estimated fair value on the date donated. No depreciation has been provided and the interest on financing during the construction period will not be capitalized in the General Fixed Assets Account Group.

#### I. Compensated Absences

Municipal employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave, or upon retirement, terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The **Municipality** accrues a liability for compensated absences, which meet the following criteria: (1) the **Municipality's** obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered; (2) the obligation relates to rights that vest or accumulate; (3) Payment of the compensation is probable; and (3) the amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by **GASB Number 16**, the **Municipality** has accrued a liability for compensated absences, which has been earned but not taken by municipal employees. The liability for compensated absences, which will not require the use of expendable available financial resource, is included in the General Long-Term Debt Account Group.

#### J. Insurance

The **Municipality** has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the **Municipality** are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the **Municipality's** insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy send to the **Municipality**.

#### K. Interfund Transactions

The **Municipality** has the following types of transactions among funds:

Residual Equity Transfers – Nonrecurring or nonroutine transfers of equity between funds. During the Fiscal Year 2001-2002 the Municipal Revenue Collection Agency, Fiscal Agent, authorized the equity transfer from Debt Service Fund to General Fund in the amount of \$3,249,713.

Operating Transfers – Legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient funds and as "Operating transfers-out" by the disbursing fund.

Transfer of Expenditures (Reimbursements) – Reimbursement of expenditures made by one fund for another that are recorded as expenditures in the reimbursing fund and as reduction of expenditures in the reimbursed fund.

#### L. Reservations of Fund Balance

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

Encumbrance – Represent future expenditures under purchases orders, contracts and other commitments issued for goods and services not received at year-end. Where the appropriations lapse at year-end these will be honored during subsequent year. Encumbrances constitute the equivalent of expenditures for budgetary purposes and, accordingly, are reported with expenditures in all budgetary basis statements.

Debt Service – Represents net assets available to finance future debt service payments.

continue

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)**

**M. Claims and Judgments**

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The General Long-Term Debt Account Group includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

**N. Use of Estimates**

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues during the reporting period. Actual result count differs from those estimates.

**NOTE 2 CASH AND INVESTMENTS**

During the year, the **Municipality** invested its funds in interest bearing bank accounts and short-term certificate of deposit. As June 30, 2002, the amount of **\$21,783,096** was invested in an interest hearing accounts in Doral Bank, Humacao Branch, that generate an annual interest rate of 5.00%. The market value of other investment recorded in General Fund approximated its carrying value as follow:

ISSUED BY	CERTIFICATE OF DEPOSIT NUMBER	PRINCIPAL AMOUNT	INTEREST RATE	EXPIRATION DATE
Popular Bank.....	2541392	<u>\$662,810</u>	2.00%	07-22-02
<b>TOTAL</b>		<u><b>\$622,810</b></u>		

**NOTE 3 INTERFUND RECEIVABLE AND PAYABLE BALANCES**

Short-term advances between funds are accounted for in the interfund receivable and payable accounts. Interfund receivable and payable balances at June 30, 2002 consist of the follows:

	INTERFUND	
	RECEIVABLE	PAYABLE
General:		
Cash Transfers and Operational Loans.....	\$ -	\$3,397,279
Interest CAE Bank Account .....	7,122	-
Special Revenue:		
Cash Transfers and Operational Loans.....	366,025	-
Capital Project:		
Cash Transfers and Operational Loans.....	3,031,254	-
Debt Service:		
Interest in CAE Bank Account .....	-	7,122
<b>TOTAL .....</b>	<u><b>\$3,404,401</b></u>	<u><b>\$3,404,401</b></u>

**NOTE 4 DUE TO OTHER GOVERNMENTAL UNITS**

As of June 30, 2002, balance due to other governmental units of the General Fund for services rendered to the **Municipality**, consists of the following:

**NOTE 4 DUE TO OTHER GOVERNMENTAL UNITS (continuation)**

	AMOUNT
Retirement System Administration .....	\$120,152
Water and Sewer Authority .....	55,503
General Service Administration .....	11,636
AEELA .....	<u>32,580</u>
<b>TOTAL .....</b>	<u><b>\$219,871</b></u>

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

**NOTE 5 PROPERTY, PLANT AND EQUIPMENT**

A summary of changes in property, plant and equipment follows:

DESCRIPTION	BALANCE JULY 1, 2001	ADDITIONS	DISPOSITIONS AND ADJUSTMENTS	BALANCE JUNE 30, 2002
Land and Buildings.....	\$ 1,818,542	\$ 7,700,00	\$19,850,871	\$29,369,413
Motor Vehicles .....	5,116,838	227,731	(924,914)	4,419,655
Machinery and Equipment .....	4,357,158	503,842	1,601,940	6,462,940
<b>TOTAL.....</b>	<b>\$11,292,538</b>	<b>\$ 8,431,573</b>	<b>\$20,527,897</b>	<b>\$40,252,008</b>

**NOTE 6 GENERAL LONG-TERM DEBTS**

**A. GENERAL OBLIGATIONS BONDS AND NOTES PAYABLE**

The principal long-term obligations of the **Municipality** are general obligations bonds and notes payable issued to finance the construction and improvements of public facilities. The **Municipality's** obligations long-term debt retirements are appropriated and paid from resources accumulated in the debt service fund (See Note 7). The special obligations long-term note retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy sent to the **Municipality**. General obligations bonds and notes payable as of June 30, 2002, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
<b>General Obligations Bonds:</b>	
\$587,000, Series 1982, payable in annual installments ranging from \$10,000 to \$37,000, excluding interests at 5.00%, through January 1, 2007 .....	\$ 173,000
\$950,000, Series 1998, payable in semiannual installments ranging from \$165,000 to \$220,000, excluding interests at 5.17%, through July 1, 2002 .....	220,000
\$1,099,000, Series 1995, payable in semiannual installments ranging from \$24,000 to \$110,000, excluding interests at 5.45%, through July 1, 2013 .....	890,000
\$1,415,000, Series 1998, payable in semiannual installments ranging from \$95,000 to \$195,000, excluding interests at 7.81%, through July 1, 2007 .....	975,000

DESCRIPTION	AMOUNT
<b>General Obligations Bonds:</b>	
\$1,485,000, Series 1995, payable in semiannual installments ranging from \$45,000 to \$155,000, excluding interests at 5.17%, through July 1, 2014.....	1,330,000
\$8,395,000, Series 1998, payable in semiannual installments ranging from \$160,000 to \$775,000, excluding interests at 6.46%, through July 1, 2018.....	7,655,000
\$1,950,000, Series 2001, payable in semiannual installments ranging from \$25,000 to \$340,000, excluding interests at 7.00%, through July 1, 2008.....	1,950,000
<b>Total General Obligations – Bonds.....</b>	<b>13,193,000</b>
<b>Special Obligations – Notes:</b>	
\$2,790,000, Series 1993, payable in semiannual installments ranging from \$215,000 to \$430,000, excluding interests at 7.81%, through July 1, 2002.....	430,000
\$4,115,000, Series 1986, payable in semiannual installments ranging from \$90,000 to \$385,000, excluding interests at 8.20%, through July 1, 2006.....	1,675,000
\$4,786,000, Series 1995, payable in semiannual installments ranging from \$126,000 to \$475,000, excluding interests at 7.81%, through July 1, 2013.....	3,855,000
\$92,204, Series 1987, payable in quarterly installments ranging from \$1,152 to \$4,610, excluding interests at 8.00%, through July 1, 2006.....	18,441
\$1,333,000, Series 1986, payable in semiannual installments ranging from \$11,000 to \$82,000, excluding interests at 10.00%, through April 1, 2006.....	563,000
\$2,000,000, Series 1990, payable in quarterly installments ranging from \$25,000 to \$100,000, excluding interests at 8.00%, through July 1, 2009.....	736,842
<b>Total Special Obligations – Notes .....</b>	<b>7,278,283</b>
<b>Total General Obligations Bonds and Notes .....</b>	<b>\$20,471,283</b>

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

**NOTE 6 GENERAL LONG-TERM DEBTS (continuation)**

The annual requirements to amortize the general and notes obligations outstanding as of June 30, 2002, are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2003	\$ 2,097,873	\$ 1,314,878	\$ 3,412,751
2004	1,552,873	1,222,370	2,775,243
2005	1,664,873	1,104,481	2,769,354
2006	1,782,874	979,068	2,761,942
After 2006	<u>13,372,790</u>	<u>4,882,776</u>	<u>18,255,566</u>
<b>TOTAL</b>	<b><u>\$20,471,283</u></b>	<b><u>\$ 9,503,573</u></b>	<b><u>\$29,974,856</u></b>

**B. OTHER LONG-TERM DEBTS**

The following is a detail of Other Long-Term Debts at year-end:

DESCRIPTION	BALANCE JULY 1, 2001	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2002
Property Tax Advance – MRCC.....	\$ 492,779	\$ -	\$ -	\$ 492,779
Unemployment .....	889,626	-	889,626	-
State Insurance Health Plan .....	1,269,099	-	148,702	1,120,397
Compensated Absences .....	2,500,197	250,790	-	2,750,987
<b>TOTAL .....</b>	<b><u>\$ 5,151,701</u></b>	<b><u>\$ 250,790</u></b>	<b><u>\$ 1,038,328</u></b>	<b><u>\$ 4,364,163</u></b>

The **Municipality** due the amount of \$1,120,397 to State Insurance Health Plan (ASES). This amount should be amortize through retention of the increase in the Electronic LOTO participation received by the **Municipality**, in accordance with Law Number 29, of July 1, 1997.

**C. CHANGES IN GENERAL LONG-TERM DEBTS**

The following is a summary of changes in long-term obligations for the fiscal year ended June 30, 2002:

DESCRIPTION	BALANCE JULY 1, 2001	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2002
General.....	\$11,909,000	\$ 1,950,000	\$ 666,000	\$13,193,000
Special.....	8,348,157	-	1,069,874	7,278,283
Others.....	5,151,701	250,790	1,038,328	4,364,163
<b>TOTAL.....</b>	<b><u>\$25,408,858</u></b>	<b><u>\$ 2,200,790</u></b>	<b><u>\$ 2,774,202</u></b>	<b><u>\$24,835,446</u></b>

**NOTE 7 DEBT RETIREMENT**

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the **Municipality** (See Note 8).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the **Municipality** (See Note 6). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

**NOTE 8 PROPERTY TAXES**

The Municipal Revenue Collection Center of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the **Municipality** and for the levy, administration and collection of the corresponding tax contribution.

The property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 7.53% for real property and 5.33% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico and 6.50% and 4.50%, respectively, belongs to the **Municipality**. From the portion belonging to the **Municipality**, 5.25% and 3.25%, respectively, represents the **Municipality's** basic tax rate that is appropriated for general purposes and therefore accounted for through the General Fund. The remaining portion belonging to the **Municipality** of 1.25% represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the Debt Service Fund (See Note 7).

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

### NOTE 8 PROPERTY TAXES (continuation)

The **Municipality** has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate. The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. However, the **Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

The **Municipality** grants a complete exemption from personal property taxes up to an assessment value of \$50,000. The Municipal Revenue Collection Center advances to the **Municipality**, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the Municipal Revenue Collection Center from taxpayers. The Municipal Revenue Collection Center periodically informs to the **Municipality** the amounts collected from taxpayers and applied to outstanding advances.

The **Municipality** records as revenue in the General Fund the exonerated portion of property tax contribution when received from quarterly advances from Municipal Revenue Collection Center. The non-exonerated portion of the advance is recorded as other financing sources in the General Fund and in the General Long-Term Debt Account Group as an increase in related debt. The revenue for the basic contribution over property not exonerated is recorded in the General Fund where the respective property tax notifications from Municipal Revenue Collection Center are received, which includes the amounts collected by such Center.

Due to the fact that collections of non-exonerated property taxes are applied to the advances of property tax send by the Municipal Revenue Collection Center, they are record as amortization of the advance in the General Long-Term Account Group, for Municipal Revenue Collection Center (MRCC), expenditures in the General Fund and recognized as revenue in accordance with GAAP.

The liquidation of Property Taxes of the current fiscal year is preliminary as stated by MRCC. During the fiscal year, the **Municipality** has receivable of \$59,717 recognized in Debt Service Fund according to measurement revenue recognition focus.

### NOTE 9 VOLUME OF BUSINESS TAX

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the **Municipality** and which are not totally or partially exempt from this tax under the Industrial Incentives Laws of the Commonwealth of Puerto Rico. All taxpayers are required to file their declarations by April 23 of each year. The tax rates are as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.50% for all other organizations

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

### NOTE 10 INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consists primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the quasi-public corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the general fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

### NOTE 11 EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico and its Instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

The **Municipality** adopted the requirements of GASB Number 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

continue

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS

### FOR THE FISCAL YEAR ENDED JUNE 30, 2002

#### NOTE 11 EMPLOYEE'S RETIREMENT PLAN (continuation)

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to accept before April 1, 1999 to contribute 5.775% for the first \$6,600 of salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. After such date, contribute 8.275% of their salaries. This is the only choice available to Mayor. The **Municipality** contributes to the system 9.275% of the participating employee's salaries.

Law Number 305 of September 24, 1999, amends the Act Number 447, that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from define contribution program to the new savings program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

All employees that do not elect to transfer for the new program, and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows:

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS
30 or more	55 or less	65% of the average of the three years of highest salary during the employee's service period.
30 or more	58 or more	75% of the average of the three years of highest salary during the employee's service period.
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990).

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation of each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- The present value of the future pension payments was computed by using a discount of 9%.
- Future pension payments reflect an assumption of a 6% salary increase.

The amount of the total pension benefit obligation is based on a standardized measurement established by **GASB Number 27, Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans**. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date.

The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan. The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and nonvested is not readily available.

Contributions in 2002 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the **Municipality** has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2002 was approximately **\$750,851**. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS are not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2002.

Also, the Head Start Program's employees are covers by a Defined Contribution Plan adopted on February 1, 2001. Substantially all employees are eligible for the Plan on or after the date in which the employees completes three months of continued service. Participants can make a voluntary contribution up to \$50 of its gross compensation, as defined in the Plan; not to exceed the limit established by law. The Head Start Program (Sponsor) contributes \$21.60 per month per employee.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**NOTES TO THE GENERAL PURPOSE FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

**NOTE 11 EMPLOYEE'S RETIREMENT PLAN (continuation)**

It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and Sections 1165 (a) and (e) of the Puerto Rico Internal Revenue Code of 1994 (PRIRC), as amended. Participants are 100% vested on both participant's and Sponsor's contributions and earnings since being eligible for participation in the Plan.

Upon termination of service due to death, disability or retirement, a participant may elect to receive either a lump-sum amount equal to the value of the participant's vested interest in his account or some other annuity alternative benefits. The Net Assets Available for Benefits is \$33,679 at June 30, 2001 in accordance to general accepted accounting principles (accrual basis). National Life Insurance Company Plus (NALIC Plus) is managing the Plan's Assets under an investment contract. Such assets are being maintained in NALIC Plus's general account and are credited with estimated earnings on the underlying investments through the year, which are adjusted retroactively after determining actual yield on investments. The estimated interest rate on earnings was 7.0%. Assets are also charged for Plan's withdrawals and administration expenses. The investment contract, included on Net Assets Available for Benefits, approximates fair value. The contract has not defined maturity and, accordingly, the fair value is the amount payable on demand.

Although the Sponsor has not expressed any intention to do so, it has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions set forth in ERISA. In the event of the termination of the Plan, reduction or suspension, the employer shall make no further contributions and the accounts of all participants shall remain fully vested and nonforfeitable.

**NOTE 12 CONTINGENCIES**

**A. CLAIMS AND JUDGMENTS**

The **Municipality** is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the **Municipality's** activities. The legal counsel of the **Municipality** has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the **Municipality** is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims. The financial statements do not include adjustment, if any, that could result from the others resolutions of legal proceeding. However, it has been the **Municipality's** experience that such actions are settled for amounts substantially less than the claimed amounts.

**B. FEDERAL GRANTS**

In the normal course of operations, the **Municipality** receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material, except for the following matter. Also, questioned costs in the amount of \$56,792.49 are pending of resolution of federal agencies.

The Federal Emergency Management Administration (FEMA) has determined that waste removal costs in the amounts of \$1,380,983 incurred by the **Municipality** for removing waste material after Hurricane Georges were not allowed under program regulations. The **Municipality** has appealed that determination by FEMA. At the present time, FEMA is conducting an audit to verify the validity of its determination of allowability. If the determination stands, the **Municipality** will have to pay this amount from its own resources. The management of the **Municipality** understands that they will prevail.

Related to this case, two (2) Plaintiffs (Contractors) are claiming the payment for removing waste material after Hurricanes Hortense and Georges. Plaintiffs claim that they are entitled to \$1,783,973 for waste removal costs and \$1,000,000 to compensate for damage. From the actual posture of the case it is impossible to evaluate fully the likelihood of Plaintiffs prevailing. However, the evidence that support the Plaintiffs position is that they must be paid at least for the cost of work performed.

**NOTE 14 BEGINNING FUND BALANCES RESTATEMENT**

Beginning Fund Balances of Debt Services Fund have been restated by accounting adjustments for accounting errors detected during the fiscal year that affect the Fund Equity of this Governmental Funds, as follows:

	DEBT SERVICES FUND
Beginning Fund Balance (Deficit) at July 1, 2001.....	\$ 6,763,693
Final Liquidation of Prior Years.....	<u>(1,034,904)</u>
Beginning Fund Balance (Deficit), as Restated, July 1, 2001	<u>\$ 7,798,602</u>

continue

# MUNICIPALITY OF HUMACAO, PUERTO RICO

## NOTES TO THE GENERAL PURPOSES FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2002

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### NOTE 15 GASB STATEMENTS NUMBERS 33, 34 (AS AMENDED), 37, 38 AND 39

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The objective of this Statement is to enhance the understandability and usefulness of the general-purpose external financial reports of state and local governments to the citizenry, legislative and oversight bodies, and investors and creditors. The minimum requirements for Basic Financial Statements and Required Supplementary Information (RSI) are:

- A. Management's Discussion and Analysis (MD&A) – a component of RSI, should introduce the basic financial statements and provide an objective and easily readable analytical of the government's financial activities based on currently known facts, decisions, or conditions. MD&A should discuss the current-year positive and negative results in comparison with the prior year, with emphasis on the current year.
- B. Basic Financial Statements – should include:
1. Government-wide Statements – The government-wide statements should display information about the reporting government as a whole, except for its fiduciary activities. The statements should include separate columns for the governmental and business-type activities of the primary government as well as for its component units. Government-wide financial statements should be prepared using the economic resources measurement focus and the accrual basis of accounting. Capital assets, including infrastructure assets, and depreciation charges are reported on these new financial statements:
    - a. Statement of Net Assets
    - b. Statement of Activities
  2. Fund Financial Statements – Fund financial statements for the primary government's governmental, proprietary, and fiduciary funds should be presented after the government-wide statements. These funds should be presented after the governmental and enterprise funds. Fiduciary statements should include financial information for fiduciary funds and similar component units. Each of the three fund categories should be reported using the measurement focus and basis of accounting required for that category.
  3. Notes to the Financial Statements – One set of notes for both financial statements.
- C. Required Supplementary Information other than MD&A. Except for MD&A, required supplementary information, including the required budgetary comparison information, should be presented immediately following the notes to the financial statements.

GASB No. 34 will begin to take effect for the **Municipality** in fiscal year beginning after June 15, 2002. Earlier application is encouraged.

Prospective reporting of general infrastructure assets is required at the effective dates of this Statement. Retroactive reporting of all major general governmental infrastructure assets is encouraged at that date. Retroactive reporting is required four (4) year after the effective date on the basic provisions for all major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980.

Governments that elect early implementation of this Statement, should also implement GASB Statement Number 33, Accounting and Financial Reporting for Nonexchange Transactions, at the same time. Also, GASB 34 was amended by GASB Number 37 and 38 for topics that should be included in the MD&A and disclosures.

On May 2002, GASB No. 39 was issued that amend GASB 14 by establishing additional guidance on the application of existing standards for the assessment of potential component units in determining the financial reporting entity. This statement is effective for financial statements for periods beginning after June 15, 2003. Earlier application is encouraged.

**END OF NOTES**

**PART II**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
AND REPORTS REQUIRED BY GOVERNMENT AUDITING  
STANDARDS AND OMB CIRCULAR A-133**

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through Department of Education:			
Child and Adult Care Food Program .....	10.558	N/AV	<u>\$ 634,878</u>
U.S. Department of Housing and Urban Development:			
Community Development Block Grant/Entitlement Grants (CDBG).....	14.218		1,386,002
Urban Development Action Grants (UDAG).....	14.221		137,913
Emergency Shelter Grants Program (ESG) .....	14.231		21,382
Lower Income Housing Assistance Program - Section 8 Moderate Rehabilitation .....	14.856		805,987
Section 8 Housing Choice Vouchers.....	14.871		<u>440,037</u>
Total U.S. Department of Housing and Urban Development ....			<u>2,791,321</u>
U.S. Department of Justice:			
Local Law Enforcement Block Grants Program.....	16.592		<u>607</u>
U.S. Department of Transportation:			
Federal Transit - Capital Investment Grants.....	20.500		<u>335,082</u>
U.S. Federal Emergency Management Agency (FEMA):			
Pass-Through Office of the Governor:			
Public Assistant Grant .....	83.544	FEMA1136DR-PR FEMA1247DR-PR	8,625 <u>44,715</u>
Total U.S. Federal Emergency Management Agency (FEMA) .			<u>53,340</u>
<b>Subtotal Expenditures of Federal Awards</b> <b>(Balance Carry Forward).....</b>			<b><u>\$ 3,815,228</u></b>

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
Subtotal of Expenditures of Federal Awards (Balance Brought Forward) .....			<u>\$ 3,815,228</u>
U. S. Department of Health and Human Services:			
Pass-Through Elderly Office:			
Special Programs for the Aging – Title III, Part C – Nutritional Services .....	93.045	N/AV	27,651
Pass-Through Administration of Families and Children:			
Child Care and Development Block Grant .....	93.575	N/AV	227,812
Early Head Start Program .....	93.600		396,231
Head Start Program.....	93.600	N/AV	<u>6,414,981</u>
Total U.S. Department of Health and Human Services .....			<u>7,066,675</u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS.....</b>			<b><u>\$10,881,903</u></b>

The accompanying Notes to Schedule of Expenditures of Federal Awards are an integral of this Schedule.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

**NOTE 1 GENERAL**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Humacao, Puerto Rico (Municipality)** and is presented on the modified accrual basis. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The reporting entity is defined in Note (1) (A) to the general-purpose combined financial statements.

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- A. The accompanying Schedule of Expenditures of Federal Awards is prepared from **Municipality's** accounting records and is not intended to present financial position or the results of operations.
- B. The financial transactions are recorded by the **Municipality** in accordance with the terms and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.
- C. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

**NOTE 3 FEDERAL CFDA NUMBER**

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

**NOTE 4 PASS THROUGH GRANTOR'S NUMBER**

State or local government redistribution of federal awards to the Municipality, treated as if 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 identifying number assigned by the pass through entity for federal awards received as a subrecipient. Numbers identified as N/AV are not available.

**NOTE 5 RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Expenditures of federal awards are reported in the **Municipality's** Combined Statement of Revenues, Expenditures and Changes in Fund Balances – All Governmental Fund Type as follows:

DESCRIPTION	SPECIAL REVENUE	CAPITAL PROJECT	TOTAL
Federal Programs Expenditures.....	\$10,546,821	\$ 335,082	\$10,881,903
State & Municipal Expenditures .....	<u>1,996,591</u>	<u>3,397,047</u>	<u>5,393,638</u>
TOTAL EXPENDITURES .....	<u>\$12,543,412</u>	<u>\$ 3,732,129</u>	<u>\$16,275,541</u>

**NOTE 6 MAJOR PROGRAMS**

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

**END OF NOTES**



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

**To the Honorable Mayor and  
Members of the Municipal Legislature  
Municipality of Humacao, Puerto Rico**

We have audited the financial statements of **Municipality of Humacao, Puerto Rico (Municipality)** as of and for the fiscal year ended June 30, 2002, and have issued our report thereon dated November 26, 2002, which was qualified because we been able to audit the fixed assets of the General Fixed Assets Account Group. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the **Municipality's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* which is described in the accompanying Schedule of Findings and Questioned Costs as item 02-II-02.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the **Municipality's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider being reportable conditions. Reportable conditions involve matters coming to our consideration relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the **Municipality's** ability to record, process, summarize and report financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 02-II-01 and 02-II-02.

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

Page 2

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general-purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable conditions mentioned above being material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the Municipality in a separate letter dated November 26, 2002.

This report is intended for the information and use of the management, other within the organization, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

*CPA Diaz PSC*  
CPA DIAZ-MARTINEZ, PSC  
Certified Public Accountants

Caguas, Puerto Rico  
November 26, 2002





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

**To the Honorable Mayor and  
Members of the Municipal Legislature  
Municipality of Humacao, Puerto Rico**

**Compliance**

We have audited the compliance of the **Municipality of Humacao, Puerto Rico (Municipality)** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2002. The **Municipality's** major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on the **Municipality's** compliance based on our audit.

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

As described in item 02-III-01 in the accompanying Schedule of Findings and Questioned Costs, **Municipality** did not comply with requirements regarding Allowable Cost/Cost Principles that are applicable to its Federal Transit – Capital Investment Grants. Compliance with such requirements is necessary, in our opinion, for **Municipality** to comply with the requirements applicable to this program.

In our opinion, except for the noncompliance described in the preceding paragraph, the **Municipality** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2002. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as items 02-III-02 through 02-III-04.

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

Page 2

**Internal Control Over Compliance**

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

We noted certain matter involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 02-III-01 through 02-III-04.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 02-III-01 being material weakness.

This report is intended for the information and use of the management, other within the organization, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



CPA DIAZ-MARTINEZ, PSC  
Certified Public Accountants

Caguas, Puerto Rico  
November 26, 2002



**PART III**

**FINDINGS AND QUESTIONED COSTS**

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

**SECTION I – SUMMARY OF AUDITORS' RESULTS**

**Financial Statements**

Type of auditors' report issued:  Unqualified Opinion  Qualified Opinion  
 Adverse Opinion  Disclaimer Opinion

Internal control over financial reporting:

● Reportable condition(s) identified?  Yes  None Reported

● Material weakness (es) identified?  Yes  No

Noncompliance material to financial statements noted?  Yes  No

**Federal Awards**

Internal control over major programs:

● Reportable condition(s) identified?  Yes  None Reported

● Material weakness (es) identified?  Yes  No

Type of auditors' report issued on compliance for Major Programs:  Unqualified Opinion All Others  Qualified Opinion for 20.500  
 Adverse Opinion  Disclaimer Opinion

Any audit finding disclosed that are required to be reported in accordance with Section 510 (a) of Circular A-133?  Yes  No

Identification of Major Programs:

CFDA NUMBER	NAME OF FEDERAL PROGRAM OR CLUSTER
14.218	Community Development Block Grant/Entitlement Programs (CDBG)
20.500	Federal Transit – Capital Investment Grants
93.575	Child Care and Development Block Grants
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B Programs: \$390,897

Auditee qualified as low-risk auditee?  Yes  No

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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**SECTION II – FINANCIAL STATEMENT FINDINGS**

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<b>FINDING</b>	<b>NUMBER 02-II-01</b>
<b>REQUIREMENT</b>	<b>REPORTABLE CONDITION OVER PROPERTY, PLANT AND EQUIPMENT</b>
<b>CONDITION</b>	During our examination of <b>Municipality's</b> property record and reports we noted the following deficiencies: (1) Construction in Progress are not accounted for as part of Property, Plant and Equipment account balance; (2) there is no adequate internal control procedure to assure the proper valuation and timeliness of recognition of real estate inventory.
<b>CRITERIA</b>	Article 9.002 of State Act Number 81 of August 30, 1991 stated that <b>Municipality</b> should maintain updated property accounting records.
<b>EFFECT</b>	<b>Municipality</b> did not maintain an adequate control of the accountability regarding property transactions.
<b>CAUSE</b>	Evidence that system fails to provide a complete and accurate output consistent with the entity's control objectives because of the misapplication of controls.
<b>RECOMMENDATION</b>	<b>Municipality</b> should implement internal control procedures in order to comply with this requirement.
<b>MANAGEMENT RESPONSE</b>	Pending the Corrective Action Plan.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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SECTION II – FINANCIAL STATEMENT FINDINGS

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<b>FINDING</b>	<b>NUMBER 02-II-02 (See Finding Number 02-III-01).</b>
<b>REQUIREMENT</b>	<b>REPORTABLE CONDITION OVER ACCOUNTING RECORDS AND NONCOMPLIANCE</b>
<b>CONDITION</b>	During our audit, we noted that the <b>Municipality</b> did not maintain a current and complete general ledger which adequately identified the source and application of Federal Transit Administration for fiscal year 2001-2002.
<b>CRITERIA</b>	Article 8.010 (c) (2) and (3) of State Act Number 81 of August 30, 1991, stated that Municipality should maintain accurate accounting records and funds controls.
<b>EFFECT</b>	<b>Municipality</b> did not maintain an adequate control of the accountability regarding cash and interfund transactions.
<b>CAUSE</b>	Evidence that system fails to provide a complete and accurate output consistent with the entity's control objectives because of the misapplication of controls.
<b>RECOMMENDATION</b>	<b>Municipality</b> should implement internal control procedures in order to comply with this requirement.
<b>MANAGEMENT RESPONSE</b>	Pending the Corrective Action Plan.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>NUMBER 02-III-01</b>
<b>FEDERAL PROGRAM</b>	<b>FEDERAL TRANSIT –CAPITAL INVESTMENT GRANTS (CFDA NO. 20.500) U.S. DEPARTMENT OF TRANSPORTATION</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>ALLOWABLE COST/COST PRINCIPLES</b>
<b>CONDITION</b>	It was noted in our tests of <b>Municipality's</b> internal control over disbursements process, that they don't have a General Ledger.
<b>CRITERIA</b>	OMB Circular A-87 has established that a cost allocable to a particular Federal award must be adequately documented to be allowable. Also Subpart C, 49 CFR 18.20 (b)(2) has established that grantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorization, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
<b>CAUSE</b>	<b>Municipality</b> did not maintain an adequate record of all transactions.
<b>EFFECT</b>	<b>Municipality</b> is not in compliance with Subpart C, 49 CFR 18.20 (b)(2).
<b>RECOMMENDATION</b>	We recommend the implementation of an adequate control over the recording process, in accordance with program regulations.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE</b>	Pending the Corrective Action Plan.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>NUMBER 02-III-02</b>
<b>FEDERAL PROGRAM</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>CASH MANAGEMENT – EXCESS CASH BALANCES</b>
<b>CONDITION</b>	<b>Municipality held high cash balances according to the bank statements. This means that federal financial assistance is sometimes requested and not used to cover immediate expenditures incurred.</b>
<b>CRITERIA</b>	Code of Federal Regulations, Subpart I, 24 CFR Section 570.489 (c) (1), stated that units of general local governments shall use procedures to minimize the time elapsing between the transfer of funds by the state and disbursement for activities, according with Treasury Circular 1075.
<b>EFFECT</b>	It could be understood that Federal Program and Finance Departments are requesting funds in excess of the immediate expenditures incurred.
<b>CAUSE</b>	The Federal Program Department did no maintain appropriate cash management procedures in order to keep low cash balances.
<b>RECOMMENDATION</b>	We recommend to management to revised their bank account balances in order to minimize the amounts held on the accounts.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE</b>	Pending the Corrective Action Plan.

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>NUMBER 02-III-03</b>
<b>FEDERAL PROGRAM</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>EQUIPMENT AND REAL PROPERTY MANAGEMENT</b>
<b>CONDITION</b>	The Federal Program Department does not have a property register that include the equipment cost, acquisition date, use and condition of property, grant or agreement, who is the legal owner and percentage of federal participation in costs. The equipment doesn't have a tag number.
<b>CRITERIA</b>	Code of Federal Regulation, Subpart C, 24 CFR 85.32(d)(1), stated that property records must be maintained that includes a description of the property, serial number or other identification number, the source of property, percentage of Federal participation in the property, the location, use and condition of the property, any ultimate disposition data including the date of disposal, sale price of property, a physical inventory of the property must be taken and the result reconciled with the property records at least once every two years, respectively.
<b>EFFECT</b>	<b>Municipality</b> is not in compliance with Subpart C, 24 CFR 85.32 (d)(1).
<b>CAUSE</b>	There is no internal control procedure implemented to assure that property register includes all necessary information, as required by Subpart C, 24 CFR 85.32 (d)(1) of Common Rules.
<b>RECOMMENDATION</b>	We recommend management to implement internal control procedures to assure that a property register of federal program is maintained.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE</b>	Pending the Corrective Action Plan.

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continue

**MUNICIPALITY OF HUMACAO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>NUMBER 02-III-04</b>
<b>FEDERAL PROGRAM</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>REPORTING</b>
<b>CONDITION</b>	The quarterly reports were not submitted on a timely basis.
<b>CRITERIA</b>	Requirements of Local Office of Department of Housing and Urban Development about Line of Credit Control Systems (LOCCS).
<b>EFFECT</b>	<b>Municipality is not in compliance with State Agency.</b>
<b>CAUSE</b>	<b>Municipality did not comply with Federal and State Laws regarding reporting.</b>
<b>RECOMMENDATION</b>	We recommend management to make the reports established by Federal and State Laws.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE</b>	Pending the Corrective Action Plan.

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continue

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**SCHEDULE OF PRIOR AUDIT'S FINDINGS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

FISCAL YEAR	FINDING NUMBER		CFDA NUMBER	FINDINGS	QUESTIONED COST	COMMENTS
<b>(1) Audit Findings that have been Fully Corrected:</b>						
2001	01-III-02	Allowable Cost/Cost Principles – Missing documentation.	14.218	\$ 8,606.50		System and procedures corrected.
			20.500	\$ 514.60		System and procedures corrected.
	01-III-04	Davis-Bacon Act.	14.218	NONE		System and procedures corrected.
			93.600	NONE		System and procedures corrected.
	01-III-06	Procurement and Suspension and Debarment – Missing clauses in contract.	14.218	NONE		System and procedures corrected.
			20.500	NONE		System and procedures corrected.
	01-III-07	Procurement and Suspension and Debarment – Missing documentation.	14.218	NONE		System and procedures corrected.
	01-III-08	Procurement and Suspension and Debarment – Quotation after received of services.	10.558	NONE		System and procedures corrected.
	01-III-09	Special Tests and Provisions – Environmental review.	14.218	NONE		System and procedures corrected.
2000-1998	1	Cash Management.	93.575	NONE		System and procedures corrected.
			83.544	NONE		System and procedures corrected.
			93.045	NONE		System and procedures corrected.
			14.855-14.857	NONE		System and procedures corrected.
			14.241	NONE		System and procedures corrected.

continue

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**SCHEDULE OF PRIOR AUDIT'S FINDINGS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

FISCAL YEAR	FINDING NUMBER		CFDA NUMBER	FINDINGS	QUESTIONED COST	COMMENTS
<b>(2) Audit Findings not Corrected or Partially Corrected:</b>						
2001	01-III-01	Allowable Cost/Cost Principles – Missing documentation.	14.218	\$54,897.51		The Finance Director and the Federal Programs Director, respectively, were instructed to review and correct the internal control over disbursement process in order to assure and keep the documents that justified it. We will continue the search of the missing vouchers in order to make it available for the auditor examination.
	01-III-02	Allowable Cost/Cost Principles – Missing documentation.	20.500	\$ 1,894.98		The Finance Director and the Planning Department Director, respectively, were instructed to review and correct the internal control over disbursement process in order to assure and keep the documents that justified it. We will continue the search of the missing vouchers in order to make it available for the auditor examination.
	01-III-03	Allowable Cost/Cost Principles – Accounting records.	20.500	NONE		The Finance Director was instructed to make the required adjustment in order to maintain a current and complete general ledger of the Federal Transit Administration Funds. This included the human resources to maintain accurate accounting and funds controls.
	01-III-05	Equipment and Real Property Management – No records.	14.218	NONE		The Finance Director and Property Officer were instructed to implement internal control procedures to assure that the property register includes a description of the federal property in order to comply with the federal regulation..

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**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**SCHEDULE OF PRIOR AUDIT'S FINDINGS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

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FISCAL YEAR	FINDING NUMBER	CFDA NUMBER	FINDINGS	QUESTIONED COST	COMMENTS
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(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE

**END OF SCHEDULE**



Escudo  
Humacao

Estado Libre Asociado de Puerto Rico  
**GOBIERNO MUNICIPAL**  
Apartado 178  
Humacao, Puerto Rico 00792

Hon. Marcelo Trujillo Panisse  
Alcalde

10 de enero de 2003

Lcda. Bárbara Sanfiozeno Zaragoza  
Comisionada  
Oficina del Comisionado de Asuntos Municipales  
P. O. Box 70167  
San Juan, PR 00936-8167

Licenciada Sanfiozeno:

① →

Me place acompañar una (2) copia del Independent Auditor's Reports on General Purpose Combined Financial Statements" (Single Audit Report) del Municipio de Humacao para el Año Fiscal terminado al 30 de junio de 2002, y una (1) copia del Informe de los Auditores Independientes sobre Cumplimiento con las Recomendaciones del Contralor y la Corrección de las Fallas Señaladas en los Informes Previos e incluidos en el Informe del Contralor M-01-03 del 28 de julio de 2000. Le incluyo además, el Plan de Acción Correctiva del Single Audit Report.

RECIBIDO  
UNIDAD DE CORREO  
JAN 22 10 10 AM '03

Carta #03-58811

De tener alguna duda o necesitar información adicional sobre estos informes puede comunicarse con el Sr. Luis A. González, Auditor Interno al 850-0075 ó al 852-3066 ext. 2210.

Cordialmente,

Marcelo Trujillo Panisse  
Alcalde

c Sr. Luis A. González  
Auditor Interno

Cartas Of. Alcalde/Envío Single Audit Report 2002-10-enc-03

Tels. 852-3066, 852-0509, 852-2000 • Fax 850-6767

*Vamos hacia un nuevo Humacao.*