

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE HUMACAO

AUDITORIA 2002-2003

30 DE JUNIO DE 2003

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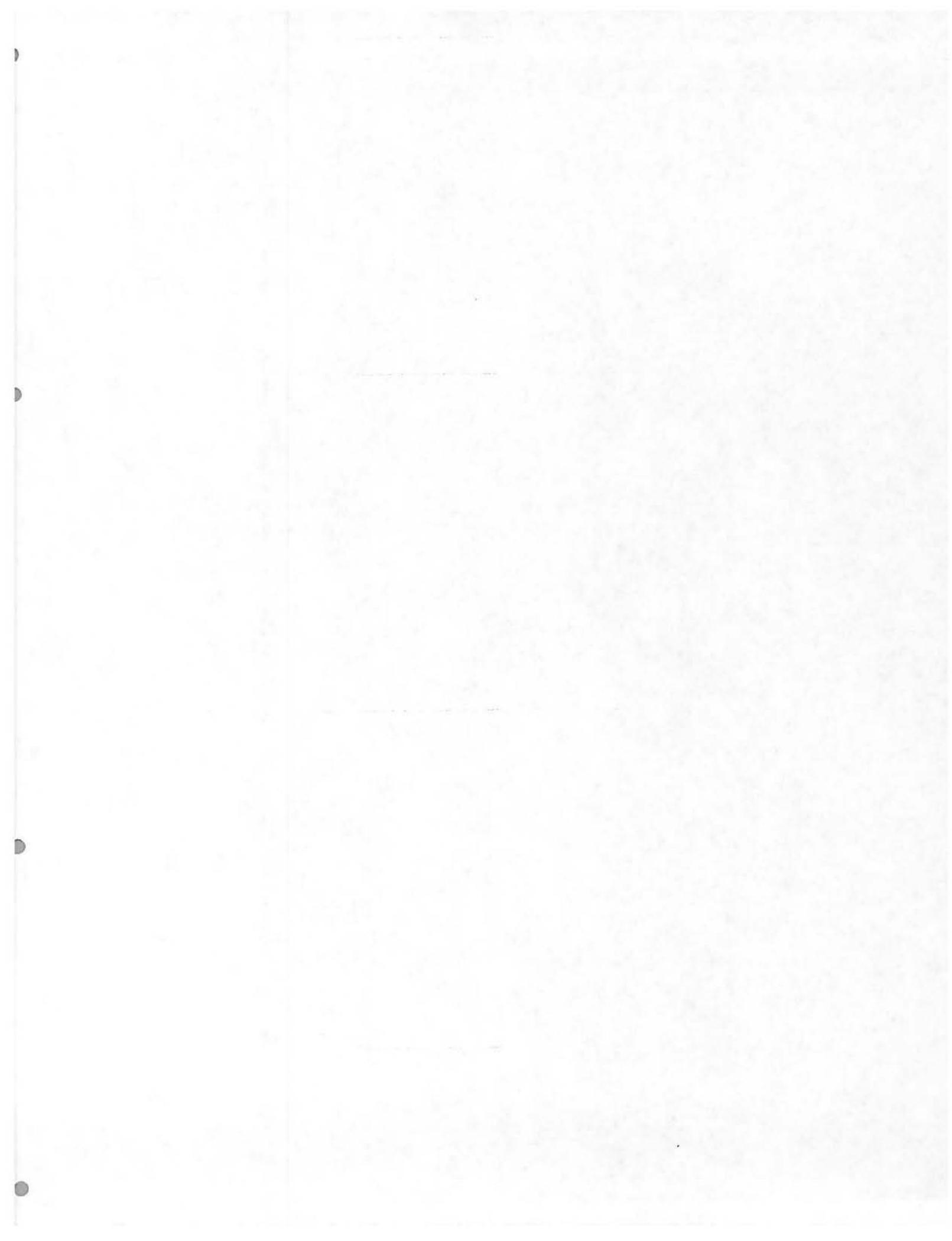
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

BASIC FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 2003

(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
BASIC FINANCIAL STATEMENTS
JUNE 30, 2003
(WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS
AND THE OMB CIRCULAR A-133)

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MUNICIPALITY OF HUMACAO, PUERTO RICO
BASIC FINANCIAL STATEMENTS
JUNE 30, 2003
(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

MENDOZA & RAMOS
CONTADORES PÚBLICOS AUTORIZADOS
PO BOX 35
GUAYAMA, PUERTO RICO 00785
Telefax (787) 864-9271

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Municipality of Humacao, Puerto Rico (Municipality), as of and for the year ended June 30, 2003, which collectively comprise the Municipality's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2003, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying Management's Discussion and Analysis and budgetary comparison information on pages 4 through 14 and 42 and 43 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As described in Notes 1 and 14, the Municipality has implemented a new financial reporting model, as required by GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* as of July 1, 2002.

INDEPENDENT AUDITORS' REPORT

Page 2

In accordance with *Government Auditing Standards*, we have also issued a report dated January 21, 2004 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.

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


MENDOZA & RAMOS, CPA's
Certified Public Accountants, C.S.P.

Guayama, Puerto Rico
January 21, 2004

Stamp number 1937208 was
affixed to the original of this
report.



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

Management's Discussion and Analysis

June 30, 2003

The Municipality of Humacao (the "Municipality") implemented Governmental Accounting Standards Board's ("GASB") Statement No. 34 – *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*, and Statement No. 37 – *Basic Financial Statements and Management Discussion and Analysis for State and Local Government: Omnibus*, during the current fiscal year ended June 30, 2003. This Management's Discussion and Analysis ("MD&A") is presented as required by such Statements.

The purpose of this document is to present the Municipality's financial performance as it is discussed and analyzed within the context of the accompanying financial statements and disclosures. As part of the Municipality's annual financial reporting, management provides here in a narrative discussion an analysis of the financial activities of the Municipality as of and for the fiscal year ended June 30, 2003. It has been designed with the following objectives:

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

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, it should be read in conjunction with the Municipality's financial statements and notes.

Financial Highlights

- The Municipality's assets exceeded liabilities at the close of its most recent fiscal year by \$62.7 million as of June 30, 2003. Of this amount, \$30 million are invested in capital assets, net of related debt, \$23.6 million are restricted for specific programs and projects, and \$9 million are unrestricted.
- The Municipality's total net assets increased by approximately \$7.05 million.
- In the governmental fund financial statements, the governmental funds' revenue increased by \$2.8 million or 6.6%, while governmental fund expenditures decreased by \$2.6 million or 5.1%.
- The Municipality's governmental funds reported combined ending fund balances of \$27.9 million, an increase of approximately \$675,000 in comparison with the previous year. Approximately 23% of the combined fund balances is considered unreserved and is available for spending at the Municipality's discretion.
- The General Fund (the primary operating fund) reflected, on a current financial resources basis, a decrease of \$6.3 millions.
- The Municipality's total debt increased by \$670 thousands during the current year. The increase is the net result of the issuance of additional debt and the refunding of prior bond issue.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$764,506.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

Management's Discussion and Analysis

June 30, 2003

Overview of the Financial Statements

Management is responsible for the fair presentation in the financial statements of the financial position, results of operations (change in Net Assets) and cash flows of the Municipality. Management is also responsible for the establishment of internal control over financial reporting and preparation of estimates that affect the presentation of assets, liabilities, revenues and expenses in the financial statements and notes thereto.

Management's Discussion and Analysis introduces the Municipality's basic financial statements. The basic financial statement include: (1) government-wide financial statements, (2) governmental fund financial statements, and (3) notes to the financial statements. The Municipality also includes in this report additional information to supplement the basic financial statements.

Government-wide Financial Statements

The Municipality's annual report includes two government-wide financial statements. These statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private sector companies with its basis in full accrual accounting.

The first of these government-wide statements is the *Statement of Net Assets*. This is the Municipality-wide statement of position presenting information that includes all of the Municipality's assets and liabilities, with the difference reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality as a whole is improving or deteriorating. Evaluation of the overall economic health of the Municipality would extend to other non-financial factors such as the Municipality's infrastructure in addition to the financial information provided in this report.

The second government-wide financial statement is the *Statement of Activities* which reports how the Municipality's net assets changed during the current fiscal year. All current year revenues and expenses are included regardless of when cash is received or paid. An important purpose of the design of the statement of activities is to show the financial reliance of the Municipality's distinct activities or functions on revenues provided by the Municipality's taxpayers.

Governmental Fund Financial Statements

A fund is an accountability unit used to maintain control over resources segregated for specific activities or objectives. The Municipality uses funds to ensure and demonstrate compliance with finance-related laws and regulations. Within the basic financial statements, fund financial statements focus on the Municipality's most significant funds rather than the Municipality as a whole. The Municipality has only one kind of fund, which is the *Governmental Fund*.

Governmental funds are reported in the fund financial statements and encompass essentially the same functions reported as governmental activities in the government-wide financial statements. However, the focus is very different with fund statements providing a distinctive view of the Municipality's governmental funds. These statements report short-term fiscal accountability focusing on the use of

COMMONWEALTH OF PUERTO RICO
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Management's Discussion and Analysis

June 30, 2003

spendable resources during the year and balances of spendable resources available at the end of the year. They are useful in evaluating annual financing requirements of governmental programs and the commitment of spendable resources for the near term.

Since government-wide focus includes the long-term view, comparisons between these two perspectives may provide insight into the long-term impact of short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to the government-wide statements to assist in understanding the differences between these two perspectives.

Budgetary comparison statements are included in the basic financial statements for the general fund. Budgetary comparison schedules for the general fund can be found in the later section of this report. These statements and schedules demonstrate compliance with the Municipality's adopted and final revised budget.

Capital Assets

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB No. 34 requires that these assets be valued and reported within the governmental column of the government-wide financial statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established level of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition of the government capital assets should assist financial statement users in evaluating a local government and its performance over time.

As of June 30, 2003, the Municipality reported all its capital assets as prescribed by GASB No. 34. Also, the Municipality elected to depreciate capital assets instead of using the modified approach.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

Management's Discussion and Analysis

June 30, 2003

Financial Analysis of the Municipality as a Whole

Net Assets

As previously noted, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's combined net assets (excess of assets over liabilities) totaled \$62.7 million at the end of 2003, compared to \$55.6 million at the end of the previous year, resulting then, in an improvement in the Municipality's financial position. The following table illustrates a summary of the Municipality's condensed net assets:

Condensed Statement of Net Assets	
June 30, 2003	
Current assets	\$ 48,697,836
Capital assets	51,055,968
	<hr/>
Total assets	\$ 99,753,804
	<hr/>
Current liabilities	11,546,603
Long term liabilities	25,505,335
	<hr/>
Total liabilities	37,051,938
	<hr/>
Net assets:	
Investment in capital assets, net of related debt	30,039,138
Restricted	23,598,228
Unrestricted	9,073,500
	<hr/>
Total net assets	\$ 62,701,866
	<hr/>

As noted, the largest portion of the Municipality's net assets is the capital assets totaling \$51.05 million, net of their related debt amounting \$21.01million. This portion represents a 48% of the Municipality's net assets. These assets are comprised by lands, buildings, motor vehicles, infrastructure assets and others, and are used by the Municipality to provide services to its citizens. Consequently, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of its related debt, it should be noted that the resources needed to pay this debt must be provided from the Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represents another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

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Management's Discussion and Analysis

June 30, 2003

Restricted net assets represent 37% of the Municipality's net assets and result when constraints placed on their use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

Changes in Net Assets

Changes in net assets are presented in the Municipality's statement of activities. The following table illustrates a condensed statement of activities for the current fiscal year:

Condensed Statement of Activities	
For the Fiscal Year ended June 30, 2003	
Program revenues:	
Operating grants and contributions	\$ 16,119,040
Capital grants and contributions	1,536,680
General revenues:	
Property taxes	13,467,702
Volume of business taxes	8,534,631
Construction taxes	2,584,851
Intergovernmental	4,895,500
Interest and investment earnings	987,819
Miscellaneous	461,883
Total revenues	<u>48,588,106</u>
Expenses:	
General government	16,122,293
Mayor and municipal legislature	1,577,721
Public safety	1,805,411
Public works	5,923,163
Culture and recreation	1,020,860
Health and sanitation	726,407
Solid waste disposal	1,480,314
Human services and health welfare	5,454,740
Urban development	2,985,884
Education	3,296,485
Interest in long-term-debt	1,136,328
Total expenses	<u>41,529,606</u>
Change in net assets	7,058,500
Net assets, beginning of year	<u>55,643,366</u>
Net assets, end of year	<u>\$62,701,866</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

Management's Discussion and Analysis

June 30, 2003

As noted above, the Municipality's net assets increased by \$7.05 million or 12.6%. Approximately, 51% of the Municipality's total revenue came from taxes, while 36% resulted from grants and contributions, including federal aid. The Municipality's expenses cover a wide array or range of services. The largest expenses were for general government, public works, human services and health welfare. In future years, when prior year information is available, a comparative analysis of government-wide data will be presented.

Financial Analysis of the Municipality's Individual Funds

As previously mentioned, the Municipality uses fund accounting to ensure and demonstrate its compliance with finance-related legal requirements.

Governmental Funds

As discussed, governmental funds are reported in the fund statements with a short-term, inflow and outflow of spendable resources focus. This information is useful in assessing resources available at the end of the year in comparison with upcoming financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$27.9 million, an increase of \$675,894 in comparison with the prior year. Of this year-end total, approximately \$6.5 million is unreserved indicating availability for continuing Municipality services. There are reservations of fund balance amounting to \$21.4 million. These are the fund balances not available for new spending because they have already been committed to:

1. liquidate contracts and purchase orders from prior years (\$642,760),
2. pay debt service (\$2.46 million), and;
3. pay for other programs and capital projects (\$18.3 million).

Major Governmental Funds

The *General Fund* is the Municipality's primary operating fund and the largest source of day-to-day service delivery. The fund balance of the General Fund decreased by \$5.4 million when compared with the previous year. Such decrease resulted mainly due to the net effect of the following factors:

- Increase of \$1.7 million in total revenues,
- Decrease of \$4.5 million in total expenditures,
- Significant decrease of \$7.3 million in other financing sources, and;
- Residual equity transfer to fund Capital Projects amounting \$6.3 million.

The increase in total revenues was mainly due to increases of \$590,679 in taxes, resulting from the improvement in the Municipality's collection efforts. In addition, intergovernmental revenues increased

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

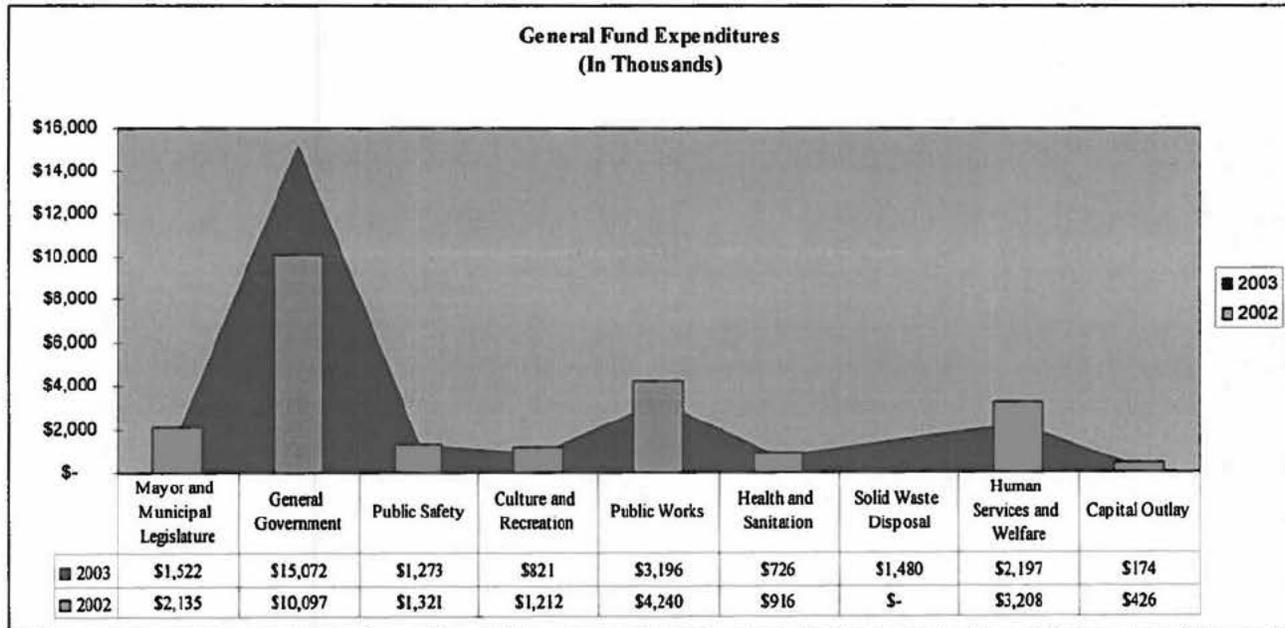
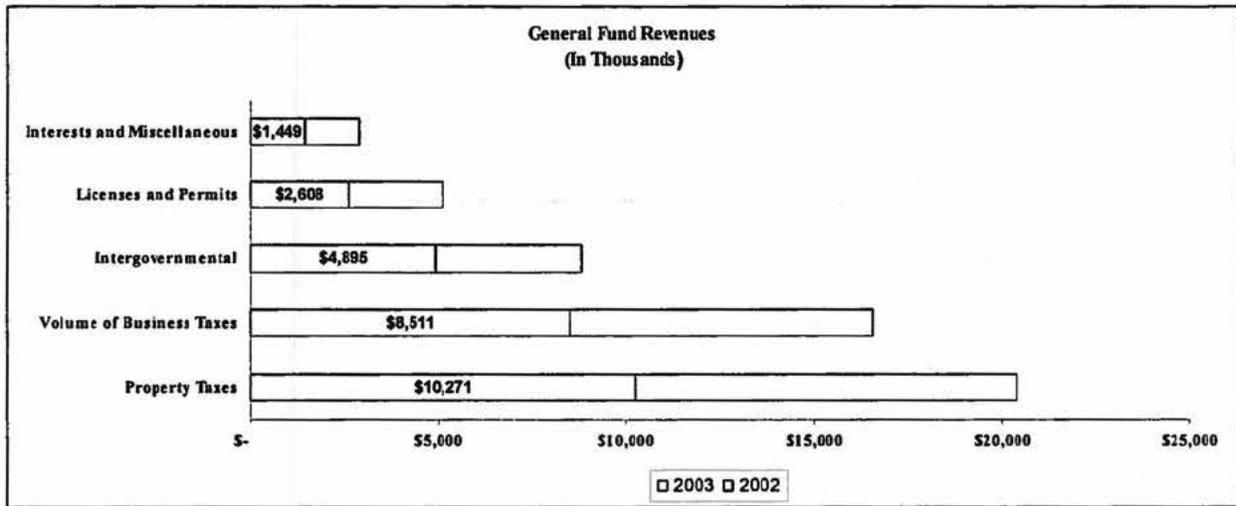
Management's Discussion and Analysis

June 30, 2003

by \$975,755, resulting from an increase in the funds received from the Puerto Rico Electric Power Authority during the current year.

The decrease in expenditures in this fund was mainly caused by the net effect of a general increase of \$2.9 million in total expenditures less the amortization of property tax advances of \$7.4 million accounted for during the previous year.

The following graphic presentation of revenues and expenditures within the general fund are included to assist in the analysis of the Municipality's activities for the current fiscal year:



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Management's Discussion and Analysis

June 30, 2003

See General Fund Budgetary Highlights for more information.

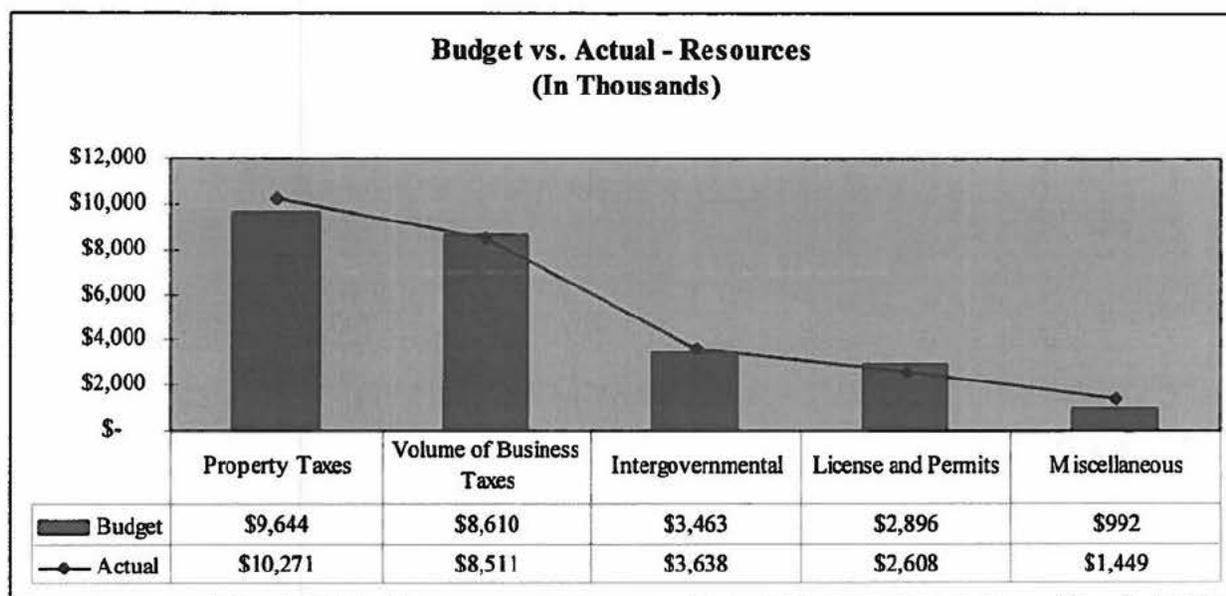
The *Debt Service Fund* is used to account for the accumulation of resources for, and the payment of, long-term debt principal and interests. This fund has a fund balance of \$2.4 million, representing a decrease of \$2.3 million. Such decrease in this fund was principally caused by the application of a new accounting principle through GASB No. 34 requiring a negative adjustment of \$2.3 million.

The *Other Governmental Funds* include what was previously presented as Special Revenue Funds and Capital Projects Fund. This fund has a fund balance of \$17.2 million, representing an increase of \$6.3 million. The increase was caused by the effect of a transfer of funds from the General Fund providing funding for capital projects.

General Fund Budgetary Highlights

The original General Fund Budget for the fiscal year 2003 amounted to \$25.4 million. Over the course of the year, Municipality's management revised the budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Finally, the budget was increased by \$155,267. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

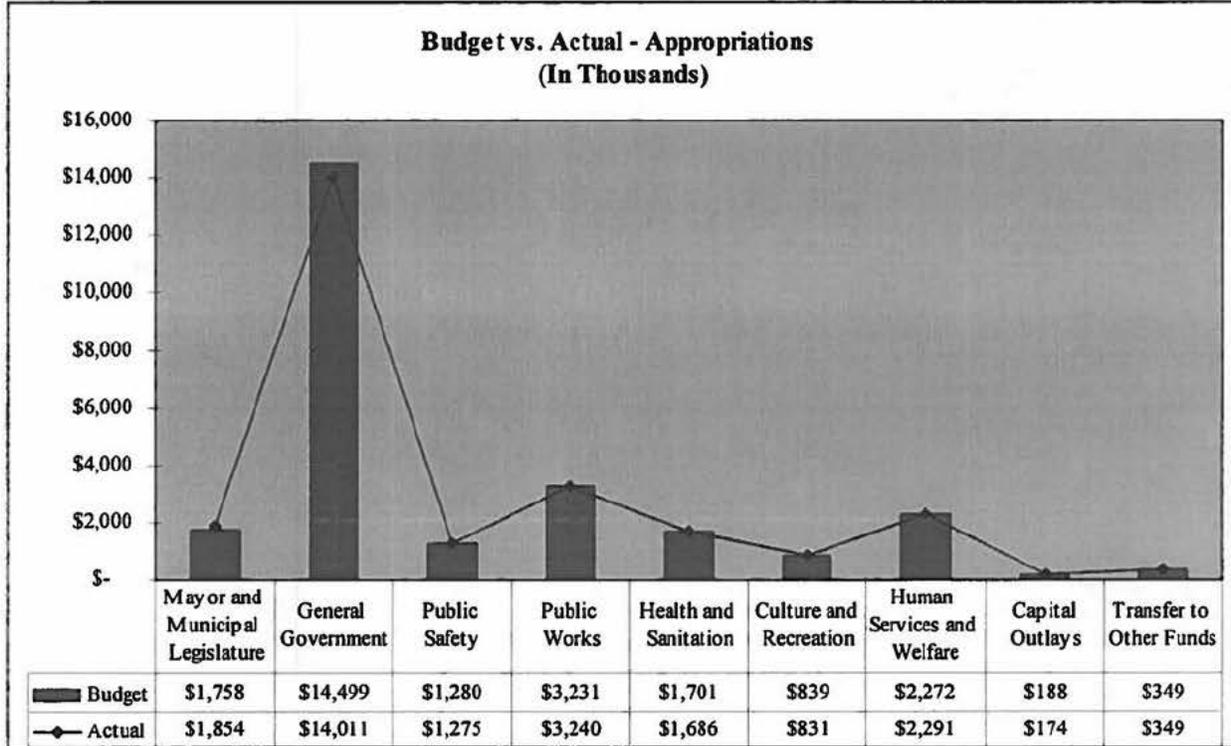
The following graph illustrates a comparison between final budget and actual amounts (budgetary basis) for assistance in the analysis of the budgetary data:



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

Management's Discussion and Analysis

June 30, 2003



The most significant variance between budget and actual results were increases in revenues from property taxes and other miscellaneous resources of \$627,328 and \$457,102, respectively, net of a shortfall in collections from licenses and permits of \$287,973. In addition, the Municipality experienced favorable results in the expenditures from the General Government which were reduced by \$487,615 with respect to budgeted amounts. Such reduction in the current year expenditures was the result of the Municipality's efforts to control growth of employee's costs together with a reduction in the cost of professional services during the current year.

Capital Assets and Debt Administration

Capital Assets

The Municipality's investment in capital assets as of June 30, 2003, amounts to \$61.9 million, net of accumulated depreciation of \$10.8 million, leaving a net book value of \$51.05 million. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the Municipality, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

Management's Discussion and Analysis

June 30, 2003

The following illustrates the composition of capital assets for fiscal years ended June 30, 2002 and 2003:

Capital Assets			
Net of Accumulated Depreciation			
	2002	2003	Change
Non-Depreciable Assets:			
Land	\$ 3,153,324	\$ 3,153,324	\$ -
Construction in progress	-	3,668,279	3,668,279
Depreciable Assets:			
Buildings	35,079,453	35,127,304	47,851
Infrastructure	4,620,821	5,584,586	963,765
Motor Vehicles	2,310,470	2,221,816	(88,654)
Equipment	1,312,650	1,300,659	(11,991)
Total Assets	\$ 46,476,718	\$ 51,055,968	\$ 4,579,250

The total increase in the Municipality's investment in capital assets for the current fiscal year was about 10% in terms of net book value. Such increase was caused by the net effect of: (1) actual expenditures to purchase or construct capital assets amounting to \$6.2 million, and; (2) the depreciation of such assets in the amount of \$1.6 million. Current year's expenditures to purchase or construct capital assets were devoted principally in the revitalization of the Municipality's main public areas such as the Public Plaza, development of recreational parks and the improvements and renovations of streets in rural and urban zones. Refer to note 6 for additional information about changes in capital assets during the current year.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

Debt Administration

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. At the end of the fiscal year, the Municipality had total bonded debt outstanding of \$21 million. This debt is comprised of general obligation bonds amounting to \$15.4 million and special obligation notes totaling \$5.5 million. The Municipality's obligations debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund and the special obligation long-term notes are paid through retentions made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy sent to the Municipality. During the current year, the Municipality issued \$4.02 million in general obligation bonds to provide funding for capital projects.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO

Management's Discussion and Analysis

June 30, 2003

Refer to notes 7, 8 and 9 for additional information on the Municipality's debt composition and administration.

Economic Environment and Next Year's Budgets and Rates

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with annual increases of approximately five percent. Federal grant revenues may vary if new grants are available. Considering that the next fiscal year represents a year of political elections, it is expected, as has occurred historically, an improvement in the island economy promoted primarily by the central government, and consequently, in the economy of the individual municipalities. This and other factors were already considered when preparing the Municipality's budget for the 2003-2004 fiscal year.

The Municipality's budget for fiscal year ending June 30, 2004 was estimated in \$28.5 million, representing an increase of 11% in comparison with the current year. The most significant change between the budgets for fiscal years 2003 and 2004 was an increase in the revenues derived from intergovernmental agencies of approximately \$1.06 million, and in revenues from health services of \$1.05 resulting from the establishment of a sound and effective billing system for the health services provided by the Municipality.

Contacting the Municipality's Financial Management

This financial analysis (including the financial statements and notes thereto) is designed to provide a general overview of the Municipality's finances and to comply with financial reporting guidelines as well as to demonstrate the Municipality's commitment to public accountability. For questions about this analysis and/or to request additional information, contact the Municipality's Finance Department at P.O. Box 178, Humacao, Puerto Rico 00792 or by calling 787-852-3066.

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

STATEMENT OF NET ASSETS

JUNE 30, 2003

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments	\$ 26,760,246
Cash with Fiscal Agent	10,191,032
Receivables (net):	
Property Taxes	863,030
Federal Grants	9,411,748
Volume of Business Tax	61,489
Others	<u>1,410,291</u>
Capital Assets (Note 6):	
Land, Improvements, and Construction in Progress	6,821,603
Other Capital Assets, [Net of Depreciation]	<u>44,234,365</u>
Total Capital Assets	<u>51,055,968</u>
TOTAL ASSETS	<u>99,753,804</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses	4,318,000
Accrued Interest	499,628
Deferred Revenue	6,728,975
Long-Term Liabilities (Note 7):	
Due within One Year	3,421,227
Due in More than One Year	<u>22,084,108</u>
Total Liabilities	<u>37,051,938</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	30,039,138
Restricted for:	
Capital Projects	8,016,428
Head Start Program	4,398,384
Debt Service	2,463,010
Community Development Projects	3,168,753
Other Purposes	5,542,653
Unrestricted	<u>9,073,500</u>
TOTAL NET ASSETS	<u>\$ 62,701,866</u>

See accompanying Notes to Basic Financial Statements.

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

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE) REVENUE SEE NEXT PAGE)
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS	
Governmental Activities:					
Mayor and Municipal Legislature	\$ 1,577,721	\$ -	\$ -	\$ -	(\$ 1,577,721)
General Government	16,122,293	-	265,994	-	(15,856,299)
Public Safety	1,805,411	-	240,008	-	(1,565,403)
Public Works	5,923,163	-	1,494,462	-	(4,428,701)
Culture and Recreation	1,020,860	-	361,323	-	(659,537)
Health and Sanitation	726,407	-	-	-	(726,407)
Solid Waste Disposal	1,480,314	-	-	-	(1,480,314)
Human Services and Welfare	5,454,740	-	3,801,600	-	(1,653,140)
Urban Development	2,985,884	-	3,699,581	1,536,680	2,250,377
Education	3,296,485	-	6,256,072	-	2,959,587
Interest on Long-Term Debt	1,136,328	-	-	-	(1,136,328)
Total Governmental Activities	\$ 41,529,606	\$ -	\$ 16,119,040	\$ 1,536,680	(23,873,886)
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes					11,048,374
Property Taxes, levied for Debt Service					2,419,328
Volume of Business Taxes					8,534,631
Construction Tax					2,584,851
Intergovernmental					4,895,500
Miscellaneous					461,883
Interest on Investments					987,819
Total General Revenues					30,932,386
CHANGE IN NET ASSETS					7,058,500
Net Assets – Beginning of Year					55,643,366
NET ASSETS – ENDING OF YEAR					\$ 62,701,866

See accompanying Notes to Basic Financial Statements.

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

BALANCE SHEET – GOVERNMENTAL FUNDS

JUNE 30, 2003

	<u>GENERAL</u>	<u>HEAD START FUND</u>	<u>DEBT SERVICE FUND</u>	<u>CDBG FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL FUNDS</u>
ASSETS						
Cash and Investments (Note 1)	\$ 21,971,420	\$ 90,621	\$ -	\$ 123,781	\$ 4,574,424	\$ 26,760,246
Cash with Fiscal Agent	214,594	-	4,230,452	-	5,745,986	10,191,032
Receivables:						
Property Taxes	776,624	-	86,406	-	-	863,030
Federal Grants	-	4,307,763	-	3,101,103	2,002,882	9,411,748
Due from Other Funds.....	49,220	-	-	-	8,189,097	8,238,317
Volume of Business Tax	61,489	-	-	-	-	61,489
Others.....	1,254,885	-	-	-	155,406	1,410,291
Total Assets.....	24,328,232	4,398,384	4,316,858	3,224,884	20,667,795	56,936,153
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts Payable.....	1,116,773	-	1,345,000	56,129	537,160	3,055,062
Accrued Interest.....	-	-	499,628	-	-	499,628
Due to Governmental Units.....	368,301	-	-	-	894,639	1,262,940
Due to Other Funds.....	8,189,097	-	9,220	-	40,000	8,238,317
Deferred Revenues:						
Volume of Business Tax	6,728,975	-	-	-	-	6,728,975
Local Grants.....	776,624	-	-	-	-	776,624
Federal Grants.....	-	3,359,368	-	3,101,103	1,957,807	8,418,278
Total Liabilities.....	17,179,770	3,359,368	1,853,848	3,157,232	3,429,606	28,979,824
Fund Balances:						
Reserve For:						
Encumbrances.....	642,760	-	-	-	-	642,760
Debt Service.....	-	-	2,463,010	-	-	2,463,010
Other Purposes.....	-	1,039,016	-	67,652	17,238,189	18,344,857
Unreserved.....	6,505,702	-	-	-	-	6,505,702
Total Fund Balances.....	7,148,462	1,039,016	2,463,010	67,652	17,238,189	27,956,329
TOTAL LIABILITIES AND FUND BALANCES.....	\$ 24,328,232	\$ 4,398,384	\$ 4,316,858	\$ 3,224,884	\$ 20,667,795	\$ 56,936,153

See accompanying Notes to Basic Financial Statements.

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

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**

JUNE 30, 2003

Total Fund Balances – Governmental Funds (Page 11)..... \$ 27,956,329

Amounts reported for Governmental Activities in the Statement of Net Assets (Page 11)
are different because:

Capital Assets used in governmental activities are not financial resources and therefore are
not reported in the funds. In the current period, these amounts are:

Non Depreciable Capital Assets.....	\$ 6,821,603	
Depreciable Capital Assets.....	48,848,108	
Infrastructure Assets.....	6,233,627	
Accumulated Depreciation.....	<u>(10,847,370)</u>	
Total Capital Assets		51,055,968

Some of the Municipality's revenues will be collected after year-end but are not available
soon enough to pay for the current period's expenditures and therefore are deferred in
the funds:

Head Start.....	3,359,370	
CDBG	3,101,103	
Municipal Revenue Collection Center	776,624	
Others.....	<u>1,957,807</u>	
Total Deferred Revenues		9,194,904

Some liabilities are not due and payable in the current period and therefore are not reported
in the funds. Those liabilities consist of:

General Bonds and Notes Payable	21,016,831	
Compensated Absences.....	2,911,736	
State Health Insurance Plan.....	1,120,397	
Property Tax Advances	<u>456,371</u>	
Total Long-Term Liabilities.....		<u>(25,505,335)</u>

Total Net Assets of Governmental Activities (Page 9)..... \$ 62,701,866

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

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE –
GOVERNMENTAL FUNDS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	GENERAL	HEAD START FUND	DEBT SERVICE FUND	CDBG FUND	OTHER GOVERNMENTAL FUNDS	TOTAL FUNDS
REVENUES						
Property Taxes	\$ 10,271,750	\$ -	\$ 2,419,328	\$ -	\$ -	\$ 12,691,078
Volume of Business Taxes	8,511,455	-	-	-	-	8,511,455
Federal Assistances	-	7,512,361	-	2,255,669	3,493,019	13,261,049
Intergovernmental	4,895,500	-	-	-	2,274,344	7,169,844
Licenses and Permits	2,608,026	-	-	-	-	2,608,026
Rent	-	-	-	-	-	-
Interest of Investment	987,819	-	-	-	-	987,819
Miscellaneous	461,883	-	-	-	-	461,883
Total Revenues	27,736,433	7,512,361	2,419,328	2,255,669	5,767,363	45,691,154
EXPENDITURES						
Current:						
Mayor and Municipal Legislature	1,522,057	-	-	-	-	1,522,057
General Government	15,072,544	-	-	-	232,184	15,304,728
Public Safety	1,273,923	-	-	-	365,133	1,639,056
Culture and Recreation	820,893	-	-	-	9,814	830,707
Public Works	3,196,289	-	-	2,188,017	1,194,627	6,578,933
Health and Sanitation	726,407	-	-	-	-	726,407
Solid Waste Disposal	1,480,314	-	-	-	-	1,480,314
Human Services and Welfare	2,197,526	-	-	-	3,211,890	5,409,416
Urban Development	-	-	-	-	2,985,884	2,985,884
Education	-	6,578,185	-	-	11,920	6,590,105
Capital Outlay	174,643	-	-	-	1,642,341	1,816,984
Debt Service:						
Principal	-	-	1,612,873	-	-	1,612,873
Interest and Other Charges	-	-	1,136,328	-	-	1,136,328
Total Expenditures	26,464,596	6,578,185	2,749,201	2,188,017	9,653,793	47,633,792
OTHER FINANCING SOURCES (USES)						
Bonds Issued	-	-	-	-	4,020,000	4,020,000
Transfers – In	62,294	-	349,738	-	-	412,032
Transfers – Out	(349,738)	-	-	-	(62,294)	(412,032)
Total Other Financing Sources and Uses	(287,444)	-	349,738	-	3,957,706	4,020,000
Net Change in Fund Balances (Page 14)	984,393	934,176	19,865	67,652	71,276	2,077,362
Fund Balance – Beginning, as Restated	12,554,982	104,840	2,443,145	-	10,776,000	25,878,967
Residual Equity Transfer	(6,390,913)	-	-	-	6,390,913	-
FUND BALANCES – ENDING	\$ 7,148,462	\$ 1,039,016	\$ 2,463,010	\$ 67,652	\$ 17,238,189	\$ 27,956,329

See accompanying Notes to Basic Financial Statements.

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

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

Net Change in Fund Balances – Total Governmental Funds (Page 13).....	\$ 2,077,362
Amounts reported for Governmental Activities in the Statement of Activities (Page 11) are different because:	
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:	
Urban Development and Capital Outlay	\$ 6,221,283
Depreciation Expense.....	<u>(1,642,033)</u>
Excess of Capital Outlay over Depreciation Expense.....	4,579,250
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.	2,896,948
Bonds proceeds provide current financial resources to governmental funds, but issuing debt increases Long-Term Liabilities in the Statement of Net Assets. In the current period, proceeds received was	(4,020,000)
Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the repayments were.....	1,685,689
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of Compensated Absences.....	<u>(160,749)</u>
Change in Net Assets of Governmental Activities (Page 10)	<u>\$ 7,058,500</u>

See accompanying Notes to Basic Financial Statements.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

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.

The accompanying basic financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the 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.

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASBS No. 34 as well as other statements referred to below as of July 1, 2002. They require new information and restructure much of the information that governments have presented in the past.

Comparability with reports issued in prior years is affected. With the implementation of GASBS No. 34, the Municipality has prepared required supplementary information titled Management's Discussion and Analysis, which precedes the basic financial statements.

As previously mentioned, other GASB Statements and Interpretations were required to be implemented in conjunction with GASBS No. 34. Therefore, the Municipality has implemented the following GASB Statements in the current fiscal year: GASBS No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, GASBS No. 38, *Certain Financial Statement Note Disclosures*, and GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The accompanying basic financial statements present the financial position and the results of operations of the Municipality and its various funds and fund types. The basic financial statements are presented as of June 30, 2003, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

A. Financial Reporting Entity

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause the Municipality's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Municipality.

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 indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the Municipality as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2003, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2003, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

Government-wide Financial Statements

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) report information of all the activities of the Municipality. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The focus of the Statement of Net Assets is designed to be similar to bottom line results for the Municipality and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term expendable resources) with capital assets and long-term obligations.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

The Statement of Net Assets presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in Capital Assets, Net of Related Debt – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- Restricted Net Assets – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted Net Assets – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

The Statement of Activities is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the Balance Sheet, the Statement of Revenues, Expenditures, and Changes in Fund Balances, the Statement of Net Assets) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and separate explanation for each differences.

The Municipality reports its financial position (Balance Sheet) and results of operations (Statement of Revenues, Expenditures and Changes in Fund Balance) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

The new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major fund:

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.

Head Start Fund – This is the fund used to account for all transactions of the Head Start Program. The objectives to this program are to provide comprehensive health, educational, nutritional, social and other developmental services primarily to economically-disadvantaged pre-school children and infants and toddlers so that the children will attain school readiness.

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

CDBG Fund – This is the fund used to account for all the transactions of the Community Development Block Grant Program. The primary objectives of this program is to development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

GASBS No. 34 eliminates the presentation of Account Groups, but provides for these records to be maintained and incorporates the information into the Governmental column in the government-wide Statement of Net Assets.

D. Budgetary Data

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 basic 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.
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 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to continue making payments for its operating and other expenses until the new budget is approved.
6. 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 Budgetary Comparison Schedule – General Fund.
7. Budgetary data for the Special Revenue Fund has not been presented in the accompanying basic 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 Budgetary Comparison Schedule, 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 10).
3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 schedule.

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Financial 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 for such programs.

E. Cash, Cash Equivalent 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 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.

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 basic financial statements.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

H. Capital Assets

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The Municipality's capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. Other costs incurred for repairs and maintenance is expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

CAPITAL ASSETS	YEARS
Buildings	50
Improvement Other Than Buildings	50
Equipments	10
Furniture	10
Vehicles	5
Machinery	5-10
Infrastructure	10-50

I. Compensated Absences

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's 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 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 accrued 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.
4. The amount can be reasonably estimated.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

In accordance with the above criteria and requirements as established by GASBS No. 16; the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations (see Note 7 on page X).

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2003.

BALANCE JULY 1, 2002	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2003	CURRENT PORTION	LONG-TERM PORTION
<u>\$2,750,987</u>	<u>\$ 160,749</u>	<u>\$ -</u>	<u>\$2,911,736</u>	<u>\$1,622,208</u>	<u>\$1,249,528</u>

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 sent to the Municipality.

K. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The Municipality has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

L. Reservations of Fund Balance – Governmental Funds

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for encumbrances, debt service, and other specific purposes are examples of the latter. 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 the budgetary comparison schedule.

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

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 Long-Term Debt Account 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

The preparation of the basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported revenue and expenses during the reporting period. Actual result could differ from those estimates.

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS

Investments consist of certificates of deposit. The Municipality's cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$100,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

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

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS (continuation)

During the year, the Municipality invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2003 the amount of \$19,964,320 was invested in an interest bearing account in Doral Bank, Humacao Branch that generates an annual interest rate of 5%. The investments are registered in the General Fund.

NOTE 3 OTHERS RECEIVABLES

As of June 30, 2003, the amount of \$77,624 corresponds to revision of Intergovernmental Revenue from Municipal Revenue Collection Center, \$1,254,885 correspond to an agreement with the quasi-public corporation, PR Electric Power Authority, for the revision of the "in lieu of tax" payment from prior years.

NOTE 4 INTERFUND TRANSFER AND BALANCES

A. INTERFUND TRANSFERS

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations.

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS

SOURCES	TRANSFER TO	AMOUNT	PURPOSE
General Fund	Debt Services Fund	\$ 349,738	Bond principal and interest payments
Other Fund	General Fund	62,294	Specific project funding
General Fund	Capital Project	<u>6,390,913</u>	Equity transfer from capital projects
Total		<u>\$ 6,802,945</u>	

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2003 are summarized as follows:

INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
General Fund	Debt Service	\$ 9,220
General Fund	Special Revenue	40,000
Special Revenue	General Fund	1,432,835
Capital Project	General Fund	<u>6,756,262</u>
TOTAL		<u>\$8,238,317</u>

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 5 DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2003, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	AMOUNT
Water Company.....	\$ 53,171
Retirement System Administration	165,425
AEELA.....	23,828
General Service Administration	11,636
State Insurance Fund Corporation.....	<u>114,241</u>
 Total Due to Governmental Units.....	 <u>\$368,301</u>

NOTE 6 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2003 was as follows:

DESCRIPTION	BALANCE JULY 1, 2002	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2003
Non-Depreciable Capital Assets:				
Land.....	\$ 3,153,324	\$ -	\$ -	\$ 3,153,324
Construction in Progress	<u>-</u>	<u>3,668,279</u>	<u>-</u>	<u>3,668,279</u>
Total Non-Depreciable Capital Assets.....	<u>3,153,324</u>	<u>3,668,279</u>	<u>-</u>	<u>6,821,603</u>
 Depreciable Capital Assets:				
Buildings	40,099,163	796,617	-	40,895,780
Infrastructure	5,182,057	1,051,570	-	6,233,627
Motor Vehicles.....	4,890,812	461,635	-	5,352,447
Equipment	<u>2,356,699</u>	<u>243,182</u>	<u>-</u>	<u>2,599,881</u>
Total Depreciable Capital Assets	<u>52,528,731</u>	<u>2,553,004</u>	<u>-</u>	<u>55,081,735</u>
 Less Accumulated Depreciation:				
Buildings	(5,019,710)	(748,766)	-	(5,768,476)
Infrastructure	(561,236)	(87,805)	-	(649,041)
Motor Vehicles.....	(2,580,342)	(550,289)	-	(3,130,631)
Equipment	<u>(1,044,049)</u>	<u>(255,173)</u>	<u>-</u>	<u>(1,299,222)</u>
Total Accumulated Depreciation.....	<u>(9,205,337)</u>	<u>(1,642,033)</u>	<u>-</u>	<u>(10,847,370)</u>
Total Depreciable Capital Assets (Net).....	<u>43,323,394</u>	<u>910,971</u>	<u>-</u>	<u>44,234,365</u>
 CAPITAL ASSETS, NET	 <u>\$46,476,718</u>	 <u>\$ 4,579,250</u>	 <u>\$ -</u>	 <u>\$51,055,968</u>

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 6 CAPITAL ASSETS (continuation)

Depreciation expenses were charged to governmental functions/programs as follows:

	AMOUNT
Mayor and Municipal Legislature	\$ 55,665
General Government	843,822
Public Safety	166,354
Public Works.....	266,284
Culture and Recreation.....	190,152
Human Services and Welfare	45,323
Urban Development	<u>74,433</u>
 Total Depreciation Expenses	 <u>\$1,642,033</u>

NOTE 7 GENERAL LONG-TERM DEBTS

A. GENERAL OBLIGATIONS BONDS AND SPECIAL NOTES PAYABLE

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (see Note 9). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy send to the Municipality.

General obligations bonds and notes payable as of June 30, 2003, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
General Obligations Bonds:	
\$4,020,000, Series 2002-03, payable in semiannual installments ranging from \$70,000 to \$310,000, excluding interests at 5.00%, through July 1, 2027.....	\$ 3,950,000
\$587,000, Series 1982, payable in annual installments ranging from \$10,000 to \$37,000 excluding interests at 5.00%, through January 1, 2007.....	140,000
\$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.....	795,000
\$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.....	695,000

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 7 GENERAL LONG-TERM DEBTS (continuation)

DESCRIPTION	AMOUNT
General Obligations Bonds:	
\$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.....	1,205,000
\$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.....	7,185,000
\$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.....	<u>1,485,000</u>
Total General Obligations – Bonds	<u>15,455,000</u>
Special Obligations – Notes:	
\$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.....	1,080,000
\$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.....	3,430,000
\$92,204, Series 1987, payable in quarterly installments ranging from \$1,152 to \$4,610, excluding interests at 8.00%, through July 1, 2006.....	13,831
\$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.....	438,000
\$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.....	<u>600,000</u>
Total Special Obligations – Notes	<u>5,561,831</u>
Total General Obligations Bonds and Notes	<u>\$21,016,831</u>

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 7 GENERAL LONG-TERM DEBTS (continuation)

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2003 are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2004	\$ 1,722,611	\$ 1,310,484	\$ 3,033,095
2005	1,839,610	1,256,147	3,095,757
2006	1,972,610	1,128,798	3,101,408
2007	1,532,000	1,001,774	2,533,774
2008	1,390,000	907,202	2,297,202
2009-2014	6,095,000	3,356,962	9,451,962
2015-2019	4,275,000	1,553,036	5,828,036
2020-2024	1,060,000	582,725	1,642,725
2025-2027	<u>1,130,000</u>	<u>189,475</u>	<u>1,319,475</u>
TOTAL	<u>\$21,016,831</u>	<u>\$11,286,603</u>	<u>\$32,303,434</u>

B. OTHER LONG-TERM DEBTS

DESCRIPTION	BALANCE JULY 1, 2002	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2003
Property Taxes – MRCC	\$ 492,779	\$ -	\$ 36,408	\$ 456,371
State Health Insurance Plan.....	1,120,397	-	-	1,120,397
Compensated Absences.....	<u>2,750,987</u>	<u>160,749</u>	<u>-</u>	<u>2,911,736</u>
TOTAL.....	<u>\$ 4,364,163</u>	<u>\$ 160,749</u>	<u>\$ 36,408</u>	<u>\$ 4,488,504</u>

C. CHANGES IN GENERAL LONG-TERM DEBTS

The following is a summary of changes in long-term debts for the year ended June 30, 2003:

DESCRIPTION	BALANCE JULY 1, 2002	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2003	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General	\$13,193,000	\$ 4,020,000	\$ 1,758,000	\$15,455,000	\$ 913,000	\$14,542,000
Special	7,278,283	-	1,716,452	5,561,831	809,611	4,752,220
Others Debts....	<u>4,364,163</u>	<u>160,749</u>	<u>36,408</u>	<u>4,488,504</u>	<u>1,698,616</u>	<u>2,789,888</u>
TOTAL	<u>\$24,835,446</u>	<u>\$ 4,180,749</u>	<u>\$ 3,510,860</u>	<u>\$25,505,335</u>	<u>\$ 3,421,227</u>	<u>\$22,084,108</u>

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 8 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 9).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 7). 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 9 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 belong 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 8). 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, to retailers with an annual net sales volume of less than \$150,000. 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 property tax contribution when received from monthly advances from Municipal Revenue Collection Center. Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipality Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 10 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 11 INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist 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 12 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 retirement 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 GASBS No. 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.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 12 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 contribute 5.775% for the first \$6,600 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. 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 defined contribution programs 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 be 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.

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:

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

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).

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 12 EMPLOYEE'S RETIREMENT PLAN (continuation)

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 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 non-vested is not readily available.

Contributions in 2003 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, 2003 was approximately \$744,798. 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 is 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, 2003. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940.

NOTE 13 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. Accordingly, the financial statements do not include adjustment, if any, that could result from the resolution of this legal proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claimed amounts.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 13 CONTINGENCIES (continuation)

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 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS

During fiscal year 2002-2003, the Municipality implemented several new accounting standards and an interpretation issued by GASB.

GASBS No. 34 as amended by GASBS No. 37 establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statement balances were required.

GASBS No. 38 requires certain note disclosures when GASBS No. 34 is implemented. The provisions of these new standards have been incorporated into the basic financial statements and notes.

GASB Interpretation No. 6 clarifies the application of existing standards for distinguishing the respective portions of certain types of liabilities that should be reported as (1) governmental fund liabilities and (2) general long-term liabilities of the government. The provisions of this interpretation have been incorporated into the basic financial statements and notes.

These new accounting standards caused most of the accounting changes, changes in reporting entity, and restatements described on the ensuing discussions below. Changes and restatements for reasons other than the adoption of the above pronouncements are also explained below.

continue

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

**NOTE 14 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS
(continuation)**

The following schedule reconciles the June 30, 2002 Fund Balances, as previously reported to Beginning Fund Balances, as restated, July 1, 2002.

FUND BALANCE RESTATED

	GENERAL	HEAD START	DEBT SERVICE	OTHERS GOVERNMENTAL FUNDS
Fund Balance, as Previously Reported, June 30, 2002.....	\$12,554,982	\$ -	\$ 4,783,554	\$ 9,941,900
Adjustment to Expenditures for Change in Accounting Principles	-	-	(2,340,409)	-
Adjustment to revenues in accordance with GAAP	-	104,840	-	834,100
Beginning Fund Balance, as Restated, July 1, 2002	<u>\$12,554,982</u>	<u>\$ 104,840</u>	<u>\$ 2,443,145</u>	<u>\$10,776,000</u>

NOTE 15 SUBSEQUENT EVENTS

The Government Development Bank of Puerto Rico approved a General Obligation Bond in the amount of \$5,200,000 to finance the construction and improvement of public facilities. The Municipal Legislature approve on August 8, 2003, a resolution to authorizing funds in advance requested to the US Department of Housing and Urban Development (HUD) for the amount of \$9,500,000 under Title I, Section 108 (Guaranteed Loans under the Housing and Urban Development Act of 1974, as amended); and to received and administer these funds for the construction of a Coliseum.

NOTE 16 FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENT

The Governmental Accounting Standards Board (GASB) issued GASBS No. 39, *Determining Whether Certain Organizations are Component Units*, which is effective for fiscal year beginning after June 15, 2003. The Municipality has not adopted the requirement of this statement.

END OF NOTES

continue

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

**REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	BUDGET AMOUNTS		ACTUAL AMOUNTS (BUDGETARY BASIS) (SEE NOTE A)	VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)
	ORIGINAL	FINAL		
BUDGETARY FUND BALANCE, JULY 1, 2003	\$ 12,554,982	\$ 12,554,982	\$ 12,554,982	\$ -
Resources (Inflows):				
Property Taxes	9,576,755	9,644,422	10,271,750	627,328
Volume of Business Taxes	8,610,000	8,610,000	8,511,455	(98,545)
Intergovernmental Revenues	3,463,444	3,463,444	3,638,517	175,073
License and Permits	2,896,000	2,896,000	2,608,027	(287,973)
Miscellaneous	905,000	992,600	1,449,702	457,102
Total Resources (Inflows).....	25,451,199	25,606,466	26,479,451	872,985
Amounts Available for Appropriation	38,006,181	38,161,448	39,034,433	872,985
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature.....	1,474,481	1,758,538	1,854,106	(95,568)
General Government.....	13,415,925	14,499,021	14,011,406	487,615
Public Safety.....	1,688,272	1,280,721	1,275,051	5,670
Public Works	3,587,556	3,231,934	3,240,759	(8,825)
Health and Sanitation.....	1,220,445	1,701,087	1,686,720	17,367
Culture and Recreation	1,028,326	839,100	831,476	7,624
Human Services and Welfare	2,477,096	2,272,146	2,291,046	(18,900)
Capital Outlays	221,951	188,082	174,643	13,439
Transfer to Other Funds.....	337,147	349,738	349,738	-
Total Charges to Appropriations.....	25,451,199	26,123,367	25,714,945	408,422
BUDGETARY FUND BALANCE, JUNE 30, 2003	\$ 12,554,982	\$ 12,038,081	\$ 13,319,488	\$ 1,281,407

See accompanying Notes to Required Supplementary Information.

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

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION**

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE A Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	<u>GENERAL FUND</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 19).....	\$ 39,034,433
Difference – Budget to GAAP:	
The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes.	(12,554,982)
Prior-Year Revenue is not inflows of budgetary resources but are <i>revenues</i> for financial reporting purposes.	<u>1,256,982</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 10).....	<u>\$ 27,736,433</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 19).....	\$ 25,714,945
Difference – Budget to GAAP:	
Prior-Year Expenditures are not outflows of budgetary resources but are <i>expenditures</i> for financial reporting purposes.	1,742,149
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes.	(642,760)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.	<u>(349,738)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 10).....	<u>\$ 26,464,596</u>

NOTE B Explanation of Differences between Budgetary Fund Balance and GAAP Fund Balance

Budgetary Fund Balance, June 30, 2003 (See Page 19).....	\$ 13,319,488
Timing Differences:	
Net Change in Encumbrances.....	(579,390)
Residual Equity Transfer	(6,390,913)
Non-budgetary Items	<u>799,277</u>
Fund Balance (See Page 10).....	<u>\$ 7,148,462</u>

END OF THIS SECTION

PART II

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

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

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

<u>FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE</u>	<u>FEDERAL CFDA NUMBER</u>	<u>PASS-THROUGH ENTITY IDENTIFYING NUMBER</u>	<u>FEDERAL EXPENDITURES</u>
U.S. Department of Agriculture:			
Pass-Through Administration of Families and Children:			
Child and Adult Care Food Program (USDA).....	10.558	N/AV	<u>\$ 633,618</u>
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Community Development Block Grants/ Entitlement Grants (CDBG)	14.218		2,188,017
Urban Development Action Grant	14.221		---
Emergency Shelter Grant Program	14.231		70,015
Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	14.856		812,454
Section 8 Housing Choice Voucher	14.871		<u>457,828</u>
Total U.S. Department of Housing and Urban Development			<u>3,528,314</u>
U.S. Department of Justice:			
Direct Programs:			
Byrne Formula Grant Program	16.579		115,623
Pass-Through Puerto Rico Department of Justice:			
Local Law Enforcement Block Grant	16.592		<u>246,510</u>
Total U.S. Department of Justice			<u>365,133</u>
U.S. Department of Transportation:			
Federal Transit – Capital Investment Grant	20.500		<u>111,792</u>
U.S. Federal Emergency Management Agency (FEMA):			
Pass-Through Office of the Governor:			
Public Assistant Grant	83.544	FEMA 1247DR-PR	<u>193,306</u>
Subtotal Expenditures of Federal Awards (Balance Carry Forward).....			<u>\$ 4,857,547</u>

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

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>\$ 4,832,163</u>
U.S. Department of Health and Human Services:			
Pass-Through Office of the Governor – Elderly Office:			
Special Program for Aging, Title III, Part C	93.045	N/AV	103,763
Pass-Through Administration of Families and Children:			
Child Care and Development Block Grant	93.575	N/AV	198,393
Early Head Start Program	93.600		816,961
Head Start Program	93.600	N/AV	<u>6,578,185</u>
Total U. S. Department of Health and Human Services			<u>7,697,302</u>
 TOTAL EXPENDITURES OF FEDERAL AWARDS			 <u>\$12,529,465</u>

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

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

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the Municipality of Humacao, Puerto Rico. 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 basic financial statements. The Municipality reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed through other government agencies are included on the Schedule.

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 Municipality in accordance with the terms records the financial transactions 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/A are not applicable and numbers identified as N/AV are not available.

NOTE 5 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 basic financial statements of Municipality of Humacao, Puerto Rico (Municipality) as of and for the fiscal year ended June 30, 2003, and have issued report thereon dated October 24, 2003. 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. 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 03-II-01 and 03-II-02.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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 described above are not 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 January 21, 2004.

**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

This report is intended solely for the information and use of the management, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Mendoza & Ramos CPAs
MENDOZA & RAMOS, CPA's
Certified Public Accountants, C.S.P.

Guayama, Puerto Rico
January 21, 2004

Stamp number 1937209 was
affixed to the original of this
report.



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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, 2003. 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 others 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.

In our opinion, 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 year ended June 30, 2003. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 03-III-01.

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

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

Page 2

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.

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

This report is intended solely for the information and use of the management, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Mendoza & Ramos, CPAs
MENDOZA & RAMOS, CPA's
Certified Public Accountants, C.S.P.

Guayama, Puerto Rico
January 21, 2004

Stamp number 1937210 was
affixed to the original of this
report.



PART III
FINDINGS AND QUESTIONED COSTS

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

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 Qualified Opinion
 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
14.871	Section 8-Housing Choice Vouchers
14.856	Section 8-Moderate 1, Moderate 2
93.600	Head Start Program
14.218	Community Development Block Grants
20.500	Federal Transit-Capital Improvements Grants

Dollar threshold used to distinguish between Type A and Type B Programs: \$307,237

Auditee qualified as low-risk auditee? Yes No

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

SECTION II – FINANCIAL STATEMENT FINDINGS

NO MATTER IS REPORTED.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 03-III-01
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPEMENT
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	In a sample of files examined, we found that in 14 cases there was no evidence on file of the following documents; Release Forms to Obtain Information to Third Parties, Federally Prescribed General Release Forms for Employment Information.
CRITERIA	24 CFR Sections 5.230, 5.609 and 982.516 requires that as a condition of admission or continued occupancy the tenant and other family members has to provide necessary information, documentation and releases to verify income eligibility.
CAUSE	Lack of proper supervision over the completeness of file documentation caused this condition.
EFFECT	Eligibility procedures can be performed without having al necessary information, leading to an incorrect eligibility determination, and that condition may not be detected timely.
RECOMMENDATION	To instruct the personnel about the documents needed when certification procedures are performed and the revise at least annually, all the CFR amendments in this area.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

FINDING	NUMBER 03-III-02
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT (CFDA 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT SECTION 8 HOUSING CHOICE VOUCHERS (CFDA 14.871) LOW INCOME HOUSING ASSISTANCE PROGRAM-SECTION MODERATE REHABILITATION (CFDA 14.856) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPEMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	CASH MANAGEMENT-EXCESS CASH BALANCES
CONDITION	Cash balances above current disbursements needs were held in bank accounts according to bank statements.
CRITERIA	24 CFR Section 570.489 (c) (1) requires that 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 by Treasury Circular 1075.
CAUSE	Proper Cash Management procedures were not maintained by the Federal Programs and Finance Departments in order to keep low cash balances.
EFFECT	Excess cash balances were maintained, leading to noncompliance with federal regulations.
RECOMMENDATION	To maintain a close supervision over the cash requesting procedures in order to avoid requesting funds when adequate cash is available.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

END OF SCHEDULE

MUNICIPALITY OF HUMACAO, PUERTO RICO

SCHEDULE OF PRIOR AUDIT'S FINDINGS

FOR THE YEAR ENDED JUNE 30, 2003

FISCAL YEAR	FINDING NUMBER		CFDA NUMBER	QUESTIONED COST	COMMENTS
(1) Audit Findings that have been Fully Corrected:					
2002	02-III-02	Cash Management- Excess Cash Balances	14.218	NONE	
	02-III-03	Equipment and Real Property Management	14.218	NONE	System and procedures corrected
	02-III-04	Reporting	14.218	NONE	System and procedures corrected
2001	01-III-01	Allowable Cost/Cost Principles – Missing documentation.	14.218	\$54,897.51	System and procedures corrected
	01-III-02	Allowable Cost/Cost Principles – Missing documentation.	14.218 20.500	\$ 8,606.50 \$ 2,409.58	System and procedures corrected System and procedures corrected
	01-III-03	Allowable Cost/Cost Principles – Accounting records.	20.500	NONE	System and procedures corrected
	01-III-04	Davis-Bacon Act.	14.218 93.600	NONE NONE	System and procedures corrected System and procedures corrected
	01-III-05	Equipment and Real Property Management – No records.	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

MUNICIPALITY OF HUMACAO, PUERTO RICO

SCHEDULE OF PRIOR AUDITS' FINDINGS

FOR THE YEAR ENDED JUNE 30, 2002

FISCAL YEAR	FINDING NUMBER	CFDA NUMBER	QUESTIONED COST	COMMENTS
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(2) Audit Findings not Corrected or Partially Corrected:

NONE

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE

END OF SCHEDULE

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RECIBIDO
UNIDAD DE CORREO

Honorable Marcelo Trujillo Panisse y
Miembros de la Asamblea Municipal
Municipio Autónomo de Humacao, Puerto Rico

En la planificación y ejecución de la auditoría de los estados financieros del Municipio Autónomo de Humacao, Puerto Rico, para el año terminado el 30 de junio de 2003, consideramos la estructura de controles internos, a los fines de determinar los procedimientos que se utilizarán en la auditoría, cuyo propósito es expresar una opinión sobre los estados financieros en general y no para proveer certeza de la estructura de controles internos.

Nuestra consideración de la estructura de controles internos no revela necesariamente, todo asunto que pueda ser una condición deficiente debido a las limitaciones inherentes sobre los sistemas de controles internos. Sin embargo, observamos ciertas situaciones en la operación de los controles internos, que, aunque no consideramos condiciones reportables, ni materiales, según definidos por los parámetros establecidos por el Instituto Americano de Contadores Públicos Autorizados, entendemos que es de beneficio a la Gerencia tener conocimiento de las mismas para tomar las acciones correctivas correspondientes.

Nuestras observaciones son las siguientes:

1. Pruebas de Desembolsos:

a. En algunos Comprobantes de Desembolso, no se observó evidencia de la certificación del recibo de la mercancía o de la realización del servicio (según aplique).

El Reglamento de Normas Básicas de los Municipios, según enmendado, en sección VIII- D-3, establece las normas para el recibo de mercancía. Entre otras cosas indica, que el Informe de Recibo, debidamente cumplimentado se enviará al Director de Finanzas para el trámite de pago correspondiente.

Esta situación puede propiciar el que se entregue mercancía que no concuerde con la orden o que los servicios brindados no cumplan con lo requerido.

b. En varios Comprobantes de Desembolso, no todos los justificantes de pago fueron debidamente cancelados.

Es norma de sana administración el que todos los justificantes de pago sean cancelados.

Esta situación puede provocar el riesgo de que una factura se pague más de una vez y la condición no sea detectada.

J. P. Panisse
2/12/04

Recomendamos al Director de Finanzas seguir los procedimientos establecidos en la Ley y el Reglamento a los fines de evitar estas situaciones.

2. Pruebas del Programa Sección 8

En nuestra evaluación de expedientes de participantes del Programa Sección 8, notamos que varios expedientes de participantes que llevan varios años recibiendo este beneficio, no se encontraban en buen estado de conservación. Los mismos contenían documentos sueltos y no estaban organizados en un orden coherente, entiéndase, relacionados entre si, y la condición general de dichos expedientes no era la más adecuada.

Los expedientes son la evidencia del trabajo realizado y deben contener toda la documentación requerida por las leyes y reglamentos.

Es norma de sana administración la conservación de documentos y que los mismos se conserven en la medida de lo posible en buen estado.

Esta situación dificultó, de forma innecesaria el examen de dicha documentación.

Recomendamos al Director de la Oficina de Programas Federales y al Coordinador del Programa de Sección 8, supervisar los procedimientos en esta área para que aseguren que la documentación de los expedientes de los participantes del Programa sea adecuada, así como su conservación.

3. Observación de Procedimientos

Observamos que el sistema de reloj utilizado para controlar la entrada y salida de los empleados, está ubicado en el pasillo del piso 3 de la casa alcaldía.

Es norma de sana administración supervisar la entrada y salida de los empleados por un oficial autorizado y que se tome nota de las tardanzas y ausencias en las que estos incurran.

Esta situación puede provocar, entre otras cosas, que un empleado que no asistió a trabajar pueda marcar su entrada y salida sin que nadie le supervise esa acción. Puede ocurrir además, que el empleado se ausente parcialmente de sus funciones, marque su entrada y salida a la hora requerida, y nadie advierta ese hecho. Además, dificulta de forma innecesaria, la fiscalización y la toma de medidas disciplinarias en caso de tardanzas y abandono de labores de un empleado.

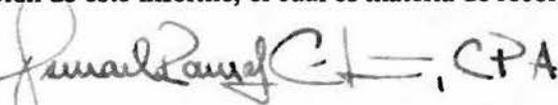
Recomendamos se evalúe la relocalización de dicho mecanismo para que el mismo sea ubicado en una oficina y que su supervisión sea asignada a una persona que responda por la información que dicho mecanismo genera.

J. R. Ruiz
11/1/04

Comentario Final

Agradecemos la cooperación del personal de las diferentes áreas durante la realización de nuestra labor.

Este informe tiene el propósito de proveerles información adicional para uso del Honorable Alcalde y los Miembros de la Asamblea Municipal. Sin embargo, esta restricción no tiene la intención de limitar la distribución de este informe, el cual es materia de récord público.

por:  CPA

Mendoza & Ramos
Contadores Públicos Autorizados, C.S.P.

Guayama, Puerto Rico
21 de enero del 2004