

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE HUMACAO

AUDITORIA 2003-2004

30 DE JUNIO DE 2004

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

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

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

Humacao

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO
HUMACAO, PUERTO RICO
BASIC FINANCIAL STATEMENTS
JUNE 30, 2004
(WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS
AND OMB CIRCULAR A-133)

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PART I
FINANCIAL

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Humacao, Puerto Rico (Municipality), as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express 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, 2004, 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 3 through 11 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.

INDEPENDENT AUDITORS' REPORT

Page 2

As described in Notes 1 and 14, during the fiscal year 2002-2003, 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 24, 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

CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
November 24, 2004

Stamp number 1937244 was
affixed to the original of this
report.



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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The management of **Municipality of Humacao, Puerto Rico (Municipality)** offers this narrative overview and analysis of the financial activities of the **Municipality** for the fiscal year ended June 30, 2004. The new reporting model required by Governmental Accounting Standards Board Statement No. 34 was implemented during fiscal 2003. The financial statements associated with it are described in the following narrative as well as in the Notes to Financial Statements.

The Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, and much of the information is comparable to prior year. We encourage readers to consider this information with the **Municipality's** basic financial statements that follow.

FINANCIAL HIGHLIGHTS

The following are key financial highlights for the fiscal year:

- ❖ The *net assets* of the **Municipality** exceeded its liabilities at June 30, 2004 by \$69.4 million and at June 30, 2003 by \$66.1 million.
- ❖ The **Municipality's** total net assets increased by \$3.3 million during 2004 and \$7.1 million during 2003.
- ❖ As of June 30, 2004, the **Municipality's** governmental funds reported combined ending fund balances of \$32.6 million, an increase of \$4.6 million from the prior year. Of this amount, \$6.1 million is available for use at the **Municipality's** discretion (*unreserved fund balance*).
- ❖ At June 30, 2004, unreserved fund balance for the General Fund was \$6.1 million, or 21 percent of total general fund expenditures and transfers out. The **Municipality's** total bonded debt increased by \$3.4 million or 16 percent during the fiscal year by new issuance of \$5.2 million for capital projects.
- ❖ The **Municipality's** capital assets increase as a result of this year's operations and the infrastructure capital assets inventory (\$3.7 million). Capital assets as of June 30, 2004 are \$54.7 million.
- ❖ The investment in capital assets for this year is \$3.0 million.
- ❖ Loans principal payments were \$1.8 million and \$3.4 million in 2004 and 2003, respectively.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This annual report consists of three components: 1) Management's Discussion and Analysis (this section), 2) Basic Financial Statements, and 3) Required Supplementary Information. In light of the fact that this is a very different presentation from the pre-GASB Statement Number 34 model, the following graphic is provided for your review (**Figure A-1** on next page 5). The Basic Financial Statements include two kinds of statements that present different views of the **Municipality** as follow:

Government-wide Statements (Reporting the Municipality as Whole)

The **Statement of Net Assets** and **Statement of Activities** are two financial statements that report information about the **Municipality**, as a whole, and about its activities similar to a private-sector business. These statements provide both short-term and long-term information about the **Municipality's** economic condition at the end of the fiscal year. These statements include all assets and liabilities using the accrual basis of

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid. The government-wide financial statements include two statements. The **Statement of Net Assets** (page 12) presents all the **Municipality's** assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets is an indicator of whether the **Municipality's** financial position is improving or deteriorating.

The **Statement of Activities** (page 13) presents information showing how the **Municipality's** net assets change during the most recent fiscal year. All the changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Fund Financial Statements (Reporting the Municipality's Major Funds)

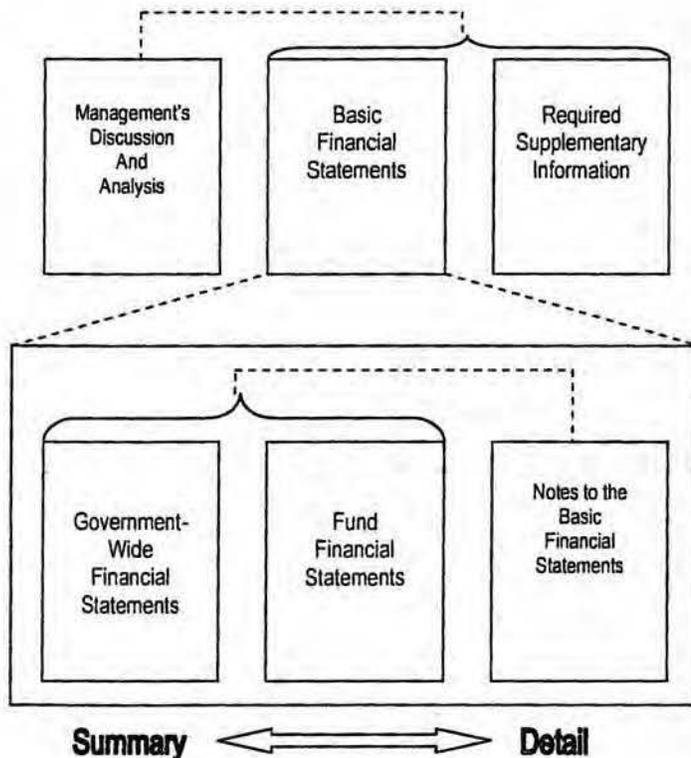
Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than (the previous financial reporting model's) fund types. The Major Fund presentation is presented on a sources and uses of liquid resources basis. This is the manner in which the financial plan (the budget) is typically developed. The fund financial statements begin on page 12 and provide detailed information about the Major Individual Funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts the **Municipality** uses to keep track of specific sources of funding and spending for a particular purpose. The **Municipality's** funds are all included in Governmental Funds.

The flow and availability of liquid resources is a clear and appropriate focus of any analysis of a government. Funds are established for various purposes and the Fund Financial Statements allows the demonstration of sources and uses and/or budgeting compliance associated therewith.

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HUMACAO, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Figure A-1
Required Component of
Municipality of Humacao Annual Financial Report



The **Municipality's** basic services are reported in the government fund financial statements. The government funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted into cash. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information containing budget to actual comparisons for the general.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Governmental Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the **Municipality**, assets exceeded liabilities by \$69.4 million as of June 30, 2004 versus \$66.1 million as of June 30, 2003. Our analysis below focuses on the net assets (**Table 1**) and changes in net assets of the **Municipality's** governmental activities.

	2004	2003
Current and non-current assets	\$ 54,383,707	\$ 48,697,836
Capital assets	<u>54,730,295</u>	<u>53,333,441</u>
Total Assets	<u>109,114,002</u>	<u>102,031,277</u>
Current liabilities	5,076,065	4,817,628
Deferred revenues	6,981,659	6,728,975
Long-term liabilities	<u>27,667,510</u>	<u>24,384,938</u>
Total Liabilities	<u>39,725,234</u>	<u>35,931,541</u>
Net Assets:		
Investment in capital assets	30,082,890	32,316,611
Restricted.....	25,169,478	23,589,228
Unrestricted.....	<u>14,136,400</u>	<u>10,193,897</u>
Total Net Assets	<u>\$ 69,388,768</u>	<u>\$ 66,099,736</u>

The largest portion of the **Municipality's** net assets reflects its investment in capital assets (e.g. land, buildings, machinery and equipment) less any related debt used to acquire those assets still outstanding. These capital assets are used to provide services to citizens; consequently these assets are not available for future spending. It should also be noted that the resources required to repay the related debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the **Municipality's** net assets represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets may be used to meet the **Municipality's** ongoing obligations to citizens and creditors.

Total Net Assets of the **Municipality's** governmental activities were \$109.1 million. *Unrestricted* Net Assets, the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements was approximately \$14.1 million at June 30, 2004.

Governmental Activities

Governmental activities increased the **Municipality's** net assets by \$6.7 million. Key elements of this increase are as follows: the **Municipality's** governmental activities had net expenses of \$31.6 million. However, these services are intended to be primarily funded by taxes, as opposed to charges for services and grants, and those taxes and other general revenues did exceed net expenses by \$3.3 million. The **Municipality** experienced a substantial increase in property taxes and construction taxes due to growth in new constructions and the assessed valuation of property within the **Municipality**.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The cost of all governmental activities this year was \$50.5 million. **Table 2** presents the cost of each of the **Municipality's** largest programs. A visual description are presented in **Graphs 1 and 2)**

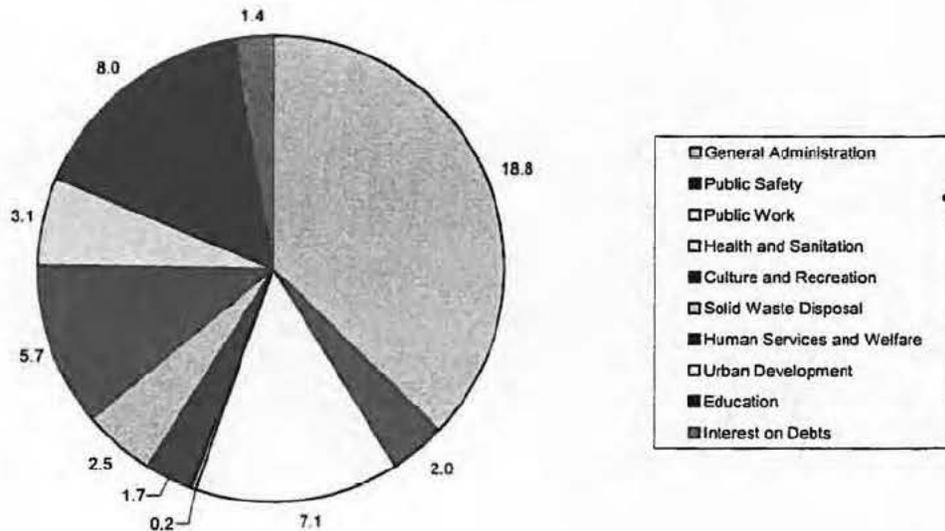
	2004	2003
Revenues:		
Program Revenues:		
Federal Grants and Contributions ...	\$ 15,820,871	\$ 15,381,374
State Grants and Contributions.....	2,997,895	2,274,346
General Revenues:		
Property Taxes.....	17,236,263	13,467,702
Volume of Business Taxes.....	8,641,649	8,534,631
Construction Taxes.....	2,987,689	2,584,851
Intergovernmental.....	4,703,430	4,895,500
Other General Revenues.....	148,692	461,883
Interest on Investments.....	<u>1,225,677</u>	<u>987,819</u>
Total revenues	<u>53,762,166</u>	<u>48,588,106</u>
Expenses:		
General Administration.....	18,746,803	17,700,014
Public Safety.....	2,034,447	1,805,411
Public Works.....	7,089,559	5,923,163
Health and Sanitation.....	191,204	726,407
Culture and Recreation.....	1,657,323	1,020,860
Solid Waste Disposal.....	2,520,427	1,480,314
Human Services and Welfare.....	5,744,314	5,454,740
Urban Development.....	3,039,253	2,985,884
Education.....	8,015,622	3,296,485
Interest Costs.....	<u>1,434,184</u>	<u>1,136,328</u>
Total expenses	<u>50,473,134</u>	<u>41,529,606</u>
Changes in net assets	3,289,032	7,058,500
Net assets – beginning, as Restated*.	<u>66,099,736</u>	<u>55,643,366</u>
Net assets – ending	<u>\$ 69,388,768</u>	<u>\$ 62,701,866</u>

Prior Period Adjustment to capital assets is \$2.3 million and \$1.1 million for debts.

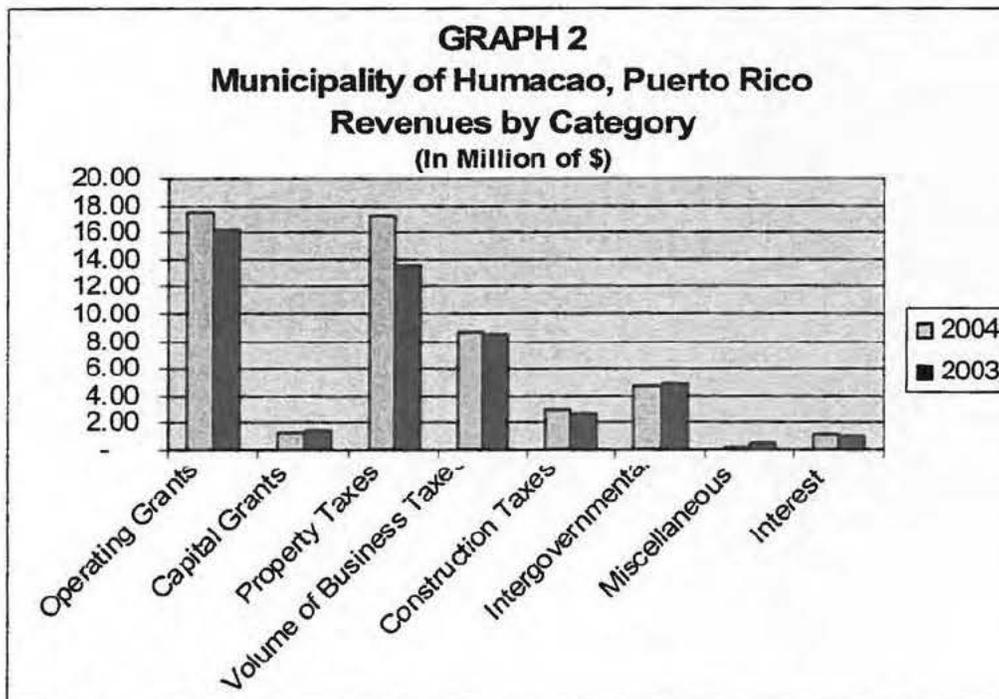
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO
HUMACAO, PUERTO RICO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**GRAPH 1
Municipality of Humacao, Puerto Rico
2004 Expenses By Functions
(In Million of \$)**



**GRAPH 2
Municipality of Humacao, Puerto Rico
Revenues by Category
(In Million of \$)**



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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

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

Governmental Funds

The focus of the **Municipality's** governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the **Municipality's** financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of its fiscal year. At June 30, 2004, the **Municipality's** governmental funds reported combined ending fund balances of \$32.6 million, an increase of \$4.6 million from the prior year.

Approximately 19% of the combined fund balances (\$6.1 million) constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of the balance is reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate prior year obligations (\$.8 million), (2) to pay debt service (\$4.1 million), or (3) for other restricted purposes (\$21.5 million).

The general fund is the chief operating fund of the **Municipality**. At June 30, 2004, unreserved fund balance of the general fund was \$6.1 million and total fund balance was \$7.0 million. As a measure of the general fund's liquidity, the total fund balance represents 23 percent of total general fund expenditures and transfers out.

BUDGETARY HIGHLIGHTS

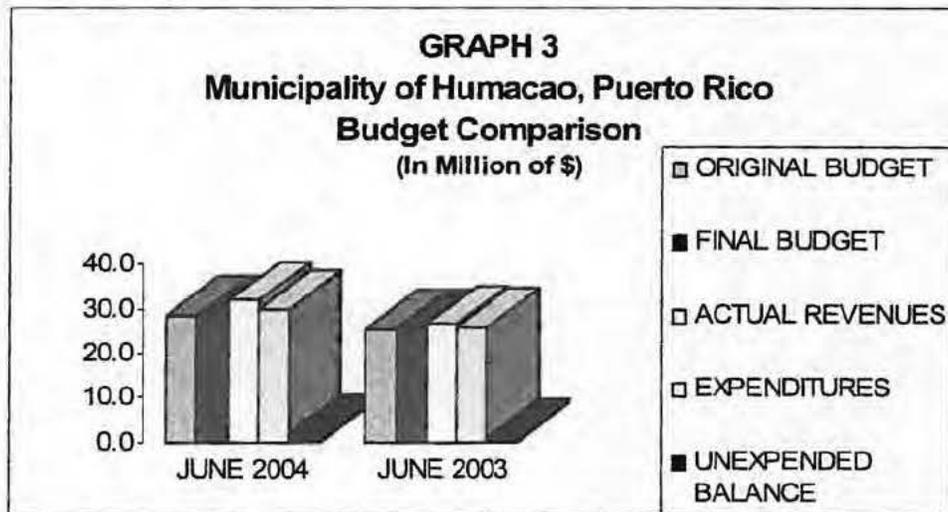
Budget and actual comparison schedules are provided in the *Basic Financial Statements* for the General Fund. The *Budgetary Comparison* Schedule of the General Fund shows the original adopted budgets, the final revised budget, actual results, and variance between the final budget and actual results for the general and major special revenue funds (see **Graph 3**).

After the original budget is approved, it may be revised for a variety of reasons such as unforeseen circumstances and other unanticipated revenues. Differences between the original 2004 budget and the final amended budget for the General Fund were relatively minor and can be summarized as follows:

- ❖ Revenues primarily increased from collections of volume of business taxes, which resulted in additional \$402,000; licenses and permits by \$430,000; and property taxes by \$3,346,000; but intergovernmental revenues decrease by \$976,000. As a result, the **Municipality** culminated its year end operations with a \$3.3 million surplus in Municipal tax collections during the year.
- ❖ Expenditures increase in some functions, principally for transfer out for capital projects, resulting in an excess of \$208,000.
- ❖ Prior Year Unreserved Fund Balance was allocated the amount of \$1.25 million, principal for capital projects.
- ❖ The original budget was amended to increase and decrease appropriation for expenditures.

**COMMONWEALTH OF PUERTO RICO
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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**



CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The **Municipality's** investment in capital assets for its governmental type activities as of June 30, 2004 amounted to \$54.7 million (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, parks, roads, highways, and bridges. The total increase in the **Municipality's** investment in capital assets for the current fiscal year was \$3.0 million.

Major capital asset events during the fiscal year included the inventory of infrastructure for the amount of \$4.9 million (net of depreciation) and other capital assets for \$2.3 million (net of depreciation). Additions during the fiscal year was principally for the construction of the buildings, new vehicles and purchases of machinery and equipment (including capital lease), necessary to provides services to our citizens. **Table 3** present the major classes of capital assets.

**Table 3
Municipality of Humacao's Capital Assets
(Net of depreciation, In Million)**

Land.....	\$ 6.3
Buildings	38.9
Infrastructure.....	4.9
Motor Vehicles	3.1
Equipment.....	1.2
Capital Lease3
Total Capital Assets	<u>\$54.7</u>

Long-term Debt

At June 30, 2004 the **Municipality** had total of \$27.7 million in general obligations and others outstanding debts, as shown in **Table 4**. Of this amount, \$24.4 million comprises debt backed by the full faith and credit of the government and \$3.3 million is other obligations.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

General Obligations	\$19.7
Special Notes.....	4.7
Others.....	<u>3.3</u>
Total Capital Assets	<u>\$27.7</u>

The **Municipality** is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the **Municipality** in order for the bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leave, and advance property taxes. More detailed information about the **Municipality's** long-term liabilities is presented in the notes to the financial statements. The **Municipality** continues to meet its financial needs through prudent use of its revenues and creative debt financing

programs.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Local, national and international economic factors influence the **Municipality's** revenues. Positive economic growth is correlated with increased revenues from property taxes, volume of business taxes, charges for services, as well as state and federal grants. Economic growth in the local economy may be measured by a variety of indicators such as employment growth, unemployment, new construction, assessed valuation, and other revenues.

All of these factors were considered in preparing the **Municipality's** budget for the 2005 fiscal year. Some cost reductions helped fund improvements of existing facilities, public safety and works, economic development initiatives and human service improvements.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the **Municipality's** finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information contact the **Municipality's** Finance Department at (787) 852-2730.

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

STATEMENT OF NET ASSETS

JUNE 30, 2004

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments	\$ 26,056,167
Cash with Fiscal Agent	15,984,026
Receivables (net):	
Property Taxes	990,332
Federal Grants	10,744,283
Others	<u>608,899</u>
Capital Assets (Note 6):	
Land, Improvements, and Construction in Progress	6,273,192
Other Capital Assets, [Net of Depreciation]	<u>48,457,103</u>
Total Capital Assets	<u>54,730,295</u>
TOTAL ASSETS	<u>109,114,002</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses	4,398,603
Accrued Interest	677,462
Deferred Revenue	6,981,659
Long-Term Liabilities (Note 7):	
Due within One Year	3,780,000
Due in More than One Year	<u>23,887,510</u>
Total Liabilities	<u>39,725,234</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	30,082,890
Restricted for:	
Debt Service	4,099,756
Head Start	5,017,413
Community Development Projects	2,148,853
Other Purposes	13,903,456
Unrestricted	<u>14,136,400</u>
TOTAL NET ASSETS	<u>\$ 69,388,768</u>

See accompanying Notes to Basic Financial Statements.

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

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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	\$ 1,882,660	\$ -	\$ -	\$ -	(\$ 1,882,660)
General Government.....	16,864,143	-	2,243,584	-	(14,620,559)
Public Safety	2,034,447	-	4,995	-	(2,029,452)
Public Works	7,089,559	-	538,425	-	(6,551,134)
Culture and Recreation	1,657,323	-	38,019	-	(1,619,304)
Health and Sanitation.....	191,204	-	-	-	(191,204)
Solid Waste Disposal	2,520,427	-	-	-	(2,520,427)
Human Services and Welfare	5,744,314	-	2,287,351	-	(3,456,963)
Urban Development	3,039,253	-	2,600,885	1,320,589	882,221
Education	8,015,622	-	9,784,918	-	1,769,296
Interest on Long-Term Debt.....	1,434,184	-	-	-	(1,434,184)
Total Governmental Activities	\$ 50,473,134	\$ -	\$ 17,498,177	\$ 1,320,589	(31,654,368)
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes					12,686,079
Property Taxes, levied for Debt Service.....					4,550,184
Volume of Business Taxes					8,641,649
Construction Tax					2,987,689
Intergovernmental					4,703,430
Miscellaneous					148,692
Interest on Investments					1,225,677
Total General Revenues					34,943,400
CHANGE IN NET ASSETS.....					3,289,032
Net Assets – Beginning of Year, As Restated (Note 14).....					66,099,736
NET ASSETS – ENDING OF YEAR.....					\$ 69,388,768

See accompanying Notes to Basic Financial Statements.

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

BALANCE SHEET – GOVERNMENTAL FUNDS

JUNE 30, 2004

	<u>GENERAL</u>	<u>HEAD START FUND</u>	<u>DEBT SERVICE FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
ASSETS					
Cash and Investments (Note 1)	\$ 21,437,136	\$ 22,253	\$ -	\$ 4,596,778	\$ 26,056,167
Cash with Fiscal Agent	214,594	-	6,146,055	9,623,377	15,984,026
Receivables:					
Property Taxes	808,077	-	182,255	-	990,332
Federal Grants	-	5,068,129	-	5,676,154	10,744,283
Due from Other Funds	692,890	-	-	7,661,663	8,354,553
Volume of Business Tax	-	-	-	-	-
Others	<u>352,364</u>	<u>-</u>	<u>-</u>	<u>256,535</u>	<u>608,899</u>
Total Assets	<u>23,505,061</u>	<u>5,090,382</u>	<u>6,328,310</u>	<u>27,814,507</u>	<u>62,738,260</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts Payable	975,260	72,968	-	974,244	2,022,472
Bonds and Notes Payable	-	-	1,540,000	-	1,540,000
Accrued Interest	-	-	677,462	-	677,462
Due to Governmental Units	339,118	-	-	497,013	836,131
Due to Other Funds	7,502,819	-	11,091	840,643	8,354,553
Deferred Revenues:					
Volume of Business Tax	6,912,897	-	-	-	6,912,897
Local Grants	808,077	-	-	-	808,077
Federal Grants	-	4,026,300	-	4,959,213	8,985,513
Total Liabilities	<u>16,538,171</u>	<u>4,099,268</u>	<u>2,228,553</u>	<u>7,271,113</u>	<u>30,137,105</u>
Fund Balances:					
Reserve For:					
Encumbrances	830,063	-	-	-	830,603
Debt Service	-	-	4,099,757	-	4,099,757
Other Purposes	-	991,114	-	20,543,394	21,534,508
Unreserved	<u>6,136,267</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,136,267</u>
Total Fund Balances	<u>6,966,890</u>	<u>991,114</u>	<u>4,099,757</u>	<u>20,543,394</u>	<u>32,601,155</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 23,505,061</u>	<u>\$ 5,090,382</u>	<u>\$ 6,328,310</u>	<u>\$ 27,814,507</u>	<u>\$ 62,738,260</u>

See accompanying Notes to Basic Financial Statements.

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

JUNE 30, 2004

Total Fund Balances – Governmental Funds (Page 14)..... \$ 32,601,155

Amounts reported for Governmental Activities in the Statement of Net Assets (Page 12)
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.....	\$ 6,273,192	
Depreciable Capital Assets	62,615,963	
Accumulated Depreciation.....	<u>(14,158,860)</u>	
Total Capital Assets.....		54,730,295

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	4,026,300	
CDBG	1,838,868	
Section 8.....	194,048	
Federal Transportation Agency	969,850	
Municipal Revenue Collection Center	1,887,685	
Others.....	<u>808,077</u>	
Total Deferred Revenues.....		9,724,828

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	24,404,220	
Capital Lease.....	243,185	
Compensated Absences	2,601,364	
Property Tax Advances	<u>418,741</u>	
Total Long-Term Liabilities		<u>(27,667,510)</u>

Total Net Assets of Governmental Activities (Page 12) \$ 69,388,768

See accompanying Notes to Basic Financial Statements.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	GENERAL	HEAD START FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES					
Property Taxes.....	\$ 12,898,002	\$ -	\$ 4,550,184	\$ -	\$ 17,448,186
Volume of Business Taxes.....	8,641,649	-	-	-	8,641,649
Federal Assistances.....	-	6,500,636	-	8,757,386	15,258,022
Intergovernmental.....	4,703,430	-	-	2,997,895	7,701,325
Licenses and Permits.....	2,987,689	-	-	-	2,987,689
Interest of Investment.....	1,225,677	-	-	-	1,225,677
Miscellaneous.....	148,692	-	-	-	148,692
Total Revenues.....	<u>30,605,139</u>	<u>6,500,636</u>	<u>4,550,184</u>	<u>11,755,281</u>	<u>53,411,240</u>
EXPENDITURES					
Current:					
Mayor and Municipal Legislature.....	1,667,350	-	-	-	1,667,350
General Government.....	14,836,968	-	-	2,640,468	17,477,436
Public Safety.....	1,924,922	-	-	473	1,925,395
Culture and Recreation.....	1,146,897	-	-	43,363	1,190,260
Public Works.....	2,505,271	-	-	4,208,447	6,713,718
Health and Sanitation.....	191,204	-	-	-	191,204
Solid Waste Disposal.....	2,520,427	-	-	-	2,520,427
Human Services and Welfare.....	3,232,342	-	-	2,427,727	5,660,069
Urban Development.....	135,079	-	-	5,110,043	5,245,122
Education.....	-	6,548,538	-	1,437,084	8,015,622
Capital Outlay.....	107,756	-	-	-	107,756
Debt Service:					
Principal.....	-	-	1,817,873	-	1,817,873
Interest and Other Charges.....	-	-	1,434,184	-	1,434,184
Total Expenditures.....	<u>28,268,216</u>	<u>6,548,538</u>	<u>3,252,057</u>	<u>15,897,605</u>	<u>53,966,416</u>
OTHER FINANCING SOURCES (USES)					
Bonds Issued.....	-	-	-	5,200,000	4,020,000
Transfers – In.....	-	-	338,620	1,143,614	1,482,234
Transfers – Out.....	(1,482,234)	-	-	-	(1,482,234)
Total Other Financing Sources and Uses.....	<u>(1,482,234)</u>	<u>-</u>	<u>338,620</u>	<u>6,343,614</u>	<u>5,200,000</u>
Net Change in Fund Balances (Page 17).....	854,689	(47,902)	1,636,747	2,201,290	4,644,824
Fund Balance – Beginning, as Restated.....	7,148,462	1,039,016	2,463,010	17,305,843	27,956,331
Residual Equity Transfer.....	(1,036,261)	-	-	1,036,261	-
FUND BALANCES – ENDING	<u>\$ 6,966,890</u>	<u>\$ 991,114</u>	<u>\$ 4,099,757</u>	<u>\$ 20,543,394</u>	<u>\$ 32,601,155</u>

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HUMACAO
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, 2004

Net Change in Fund Balances – Total Governmental Funds (Page 16).....		\$ 4,644,824
Amounts reported for Governmental Activities in the Statement of Activities (Page 13) 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	\$ 2,693,339	
Depreciation Expense	<u>(1,594,313)</u>	
Excess of Capital Outlay over Depreciation Expense		1,099,026
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.....		524,664
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		(5,200,000)
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.....		1,910,147
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>310,371</u>
Change in Net Assets of Governmental Activities (Page 13).....		<u>\$ 3,289,032</u>

**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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 and sanitation, public works, sanitation, public safety, human services and welfare, culture and recreation, solid waste disposal 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.

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 fiscal year 2002-2003: 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*, GASB No. 41, *Budgetary Comparison Schedules – Perspective Differences*, 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, 2004, 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
HUMACAO, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

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, 2004, 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.

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

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NOTES TO THE BASIC FINANCIAL STATEMENTS

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, 2004, 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 spendable resources) with capital assets and long-term obligations.

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.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

- 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.

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:

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NOTES TO THE BASIC FINANCIAL STATEMENTS

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.

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.

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 to 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.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

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 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.
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.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

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.

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.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

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

<u>CAPITAL ASSETS</u>	<u>YEARS</u>
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.

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 29).

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2004.

BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2004	CURRENT PORTION	LONG-TERM PORTION
<u>\$2,911,736</u>	<u>\$ -</u>	<u>\$ 310,372</u>	<u>\$2,601,364</u>	<u>\$1,710,496</u>	<u>\$ 890,868</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS

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.

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 debt service and other specific purposes are examples of the latter.

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.

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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.

During the year, the Municipality invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2004 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, 2004, the amount of \$808,077 corresponds to revision of Intergovernmental Revenue from Municipal Revenue Collection Center, \$350,243 correspond to an amnesty granted by the Government of Puerto Rico over the delinquent property taxes 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	\$ 338,620	Bond principal and interest payments
General Fund	Special Revenue Fund	345,609	Specific project funding
General Fund	Capital Project	<u>798,005</u>	Equity transfer from capital projects
	Total	<u>\$1,482,234</u>	

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NOTES TO THE BASIC FINANCIAL STATEMENTS

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2004 are summarized as follows:

INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
General Fund	Debt Service	\$ 11,091
General Fund	Special Revenue	294,793
General Fund	Capital Project	387,006
Special Revenue – Moderate Rehabilitation	Special Revenue – Section 8	158,844
Special Revenue	General Fund	1,404,684
Capital Project	General Fund	<u>6,098,135</u>
TOTAL		<u>\$8,354,553</u>

NOTE 5: DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2004, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	AMOUNT
Retirement System Administration	\$170,081
AEELA.....	34,018
State Insurance Fund Corporation.....	<u>135,019</u>
Total Due to Governmental Units	<u>\$339,118</u>

NOTE 6: CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2004 was as follows:

<u>DESCRIPTION</u>	<u>BALANCE JULY 1, 2003</u>	<u>ADJUSTMENTS</u>	<u>ADDITIONS</u>	<u>RETIREMENTS</u>	<u>BALANCE JUNE 30, 2004</u>
Non-Depreciable Capital Assets:					
Land	\$ 3,153,324	\$ 3,119,868	\$ -	\$ -	\$ 6,273,192
Construction in Progress.....	<u>3,668,279</u>	<u>(3,668,279)</u>	-	-	-
Total Non-Depreciable Capital Assets	<u>6,821,603</u>	<u>(548,411)</u>	-	-	<u>6,273,192</u>
Depreciable Capital Assets:					
Buildings	40,895,780	4,573,467	1,904,986	-	47,374,233
Infrastructure	6,233,627	(794,215)	360,534	-	5,799,946
Motor Vehicles.....	5,352,447	1,593,024	180,835	-	7,126,306
Equipment	2,599,881	(829,215)	246,984	-	2,017,650
Capital Lease.....	-	-	297,828	-	<u>297,828</u>
Total Depreciable Capital Assets.....	<u>55,081,735</u>	<u>4,543,061</u>	<u>2,991,167</u>	-	<u>62,615,963</u>

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Less Accumulated Depreciation:					
Buildings	(5,768,476)	(1,843,444)	(824,072)	-	(8,435,992)
Infrastructure	(649,041)	(153,927)	(101,134)	-	(904,102)
Motor Vehicles	(3,130,631)	(373,005)	(501,882)	-	(4,005,518)
Equipment	(1,299,222)	653,199	(132,478)	-	(778,501)
Capital Lease	-	-	(34,747)	-	(34,747)
Total Accumulated Depreciation.....	(10,847,370)	(1,717,177)	(1,594,313)	-	(14,158,860)
Total Depreciable Capital Assets (Net)	44,234,365	2,825,884	1,396,854	-	48,457,103
CAPITAL ASSETS, NET.....	\$51,055,968	\$ 2,277,473	\$ 1,396,854	\$ -	\$54,730,295

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

	<u>AMOUNT</u>
Mayor and Municipal Legislature	\$ 215,311
General Government	143,923
Public Safety	124,254
Public Works	499,866
Culture and Recreation	467,063
Human Services and Welfare	84,244
Urban Development	<u>59,651</u>
Total Depreciation Expenses	<u>\$1,594,313</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, 2004, are comprised of the following individual issues:

DESCRIPTION	AMOUNTS
General Obligations Bonds:	
\$5,200,000, Series 2003-04, for construction purposes, payable in annual installments ranging from \$90,000 to \$405,000, excluding interests at 5.00%, through July 1, 2028.....	\$ 5,110,000
\$4,020,000, Series 2002-03, for the acquisition of building, payable in semiannual installments ranging from \$70,000 to \$310,000, excluding interests at 5.00%, through July 1, 2027	3,875,000

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\$587,000, Series 1982, for construction purposes, payable in annual installments ranging from \$10,000 to \$37,000 excluding interests at 5.00%, through January 1, 2007...	107,000
\$1,099,000, Series 1995, for purchase of equipment, payable in semiannual installments ranging from \$24,000 to \$110,000, excluding interests at 5.45%, through July 1, 2013.....	740,000
\$1,415,000, Series 1998, for construction purposes and payment of claims and judgments, payable in semiannual installments ranging from \$95,000 to \$195,000, excluding interests at 7.81%, through July 1, 2007.....	540,000
\$1,485,000, Series 1995, for construction purposes, payable in semiannual installments ranging from \$45,000 to \$155,000, excluding interests at 5.17%, through July 1, 2014.....	1,135,000
\$8,395,000, Series 1998, for construction purposes, payable in semiannual installments ranging from \$160,000 to \$775,000, excluding interests at 6.46%, through July 1, 2018....	6,920,000
\$1,950,000, Series 2001, for purchase of equipment, payable in semiannual installments ranging from \$25,000 to \$340,000, excluding interests at 7.00%, through July 1, 2008.....	<u>1,225,000</u>
Total General Obligations – Bonds	<u>19,652,000</u>
Special Obligations – Notes:	
\$4,115,000, Series 1986, for operational purpose, payable in semiannual installments ranging from \$90,000 to \$385,000, excluding interests at 8.20%, through July 1, 2006.....	745,000
\$4,786,000, Series 1995, for refinancing purpose, payable in semiannual installments ranging from \$126,000 to \$475,000, excluding interests at 7.81%, through July 1, 2013....	3,195,000
\$92,204, Series 1987, for operational purpose, payable in quarterly installments ranging from \$1,152 to \$4,610, excluding interests at 8.00%, through July 1, 2006.....	9,220
\$1,333,000, Series 1986, for operational purpose, payable in semiannual installments ranging from \$11,000 to \$82,000, excluding interests at 10.00%, through April 1, 2006....	303,000
\$2,000,000, Series 1990, for operational purpose, payable in quarterly installments ranging from \$25,000 to \$100,000, excluding interests at 8.00%, through July 1, 2009.....	<u>500,000</u>
Total Special Obligations – Notes	<u>4,752,220</u>
Total General Obligations Bonds and Notes.....	<u>\$24,404,220</u>

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The annual requirements to amortize the general and special obligations outstanding as of June 30, 2004 are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2005	\$ 1,934,610	\$ 1,464,885	\$ 3,399,495
2006	2,072,610	1,458,073	3,530,683
2007	1,637,000	1,321,249	2,958,249
2008	1,505,000	1,219,853	2,724,853
2009	1,245,000	1,128,647	2,373,647
2010-2014	6,560,000	4,345,979	10,905,979
2015-2019	4,605,000	2,407,822	7,012,822
2020-2024	2,505,000	1,269,125	3,774,125
2025-2028	<u>2,340,000</u>	<u>362,050</u>	<u>2,702,050</u>
TOTAL	<u>\$24,404,220</u>	<u>\$14,977,682</u>	<u>\$39,381,902</u>

B. OBLIGATION UNDER CAPITAL LEASES

The Municipality is obligated under certain capital leases accounted for in the Statement of Net Assets. The historical cost, accumulated depreciation, future minimum lease payments at June 30, 2004, are as follows:

Cost.....	<u>\$297,828</u>
Accumulated Depreciation	<u>\$ 34,747</u>
Monthly Lease Payments	<u>\$ 8,893</u>
Residual Lease Payment.....	<u>\$ 43,941</u>
YEAR ENDING	TOTAL
JUNE 30,	PAYMENT
2005	\$106,713
2006	106,713
2007	<u>44,464</u>
Total Minimum Lease Payments.....	257,890
Less: Deferred Interest	<u>14,705</u>
Present Value Minimum Lease Payments.....	<u>\$243,185</u>

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C. OTHER LONG-TERM DEBTS

DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2004
Property Taxes – MRCC	\$ 456,371	\$ -	\$ 37,630	\$ 418,741
State Health Insurance Plan.....	1,120,397	-	1,120,397	-
Compensated Absences.....	<u>2,911,736</u>	<u>-</u>	<u>310,372</u>	<u>2,601,364</u>
TOTAL.....	<u>\$ 4,488,504</u>	<u>\$ -</u>	<u>\$ 1,468,399</u>	<u>\$ 3,020,105</u>

D. CHANGES IN GENERAL LONG-TERM DEBTS

The following is a summary of changes in long-term debts for the year ended June 30, 2004:

DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2004	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General	\$15,455,000	\$ 5,200,000	\$ 1,003,000	\$19,652,000	\$ 1,068,000	\$18,584,000
Special	5,561,831	-	809,611	4,752,220	866,610	3,885,610
Capital Lease	-	297,828	54,643	243,185	97,261	145,924
Others Debts.....	<u>4,488,504</u>	<u>-</u>	<u>1,468,399</u>	<u>3,020,105</u>	<u>1,748,129</u>	<u>1,271,976</u>
TOTAL.....	<u>\$25,505,335</u>	<u>\$ 5,497,828</u>	<u>\$ 3,335,653</u>	<u>\$27,667,510</u>	<u>\$ 3,780,000</u>	<u>\$23,887,510</u>

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.

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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.

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.

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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.

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 invest 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.

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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).

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 2004 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.

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The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2004 was approximately \$775,845. 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, 2004. 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

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.

NOTE 14: NET ASSETS RESTATEMENTS

During fiscal year 2002-2003, the Municipality implemented several new accounting standards and an interpretation issued by GASB. As part of the implementation of the new standards, during the current fiscal year 2003-2004, the Municipality continued the documentation of capital assets not previously reported and the inventory of infrastructure.

The other adjustment corresponded to the State Health Insurance Plan, which debt should be amortize through retention of the increase in the Electronic LOTO participation received by the Municipality, in accordance with Law Number 29, of July 1, 1997.

The following schedule reconciles the June 30, 2003 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2003.

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NOTES TO THE BASIC FINANCIAL STATEMENTS

	NET ASSETS
Net Assets, as Previously Reported, June 30, 2003	\$62,701,866
Adjustment to Long-Term Debt	1,120,397
Adjustment to Capital Assets	<u>2,277,473</u>
Beginning Net Assets, as Restated, July 1, 2003	<u>\$66,099,736</u>

NOTE 15: FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENT

The Governmental Accounting Standards Board (GASB) issued GASBS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal year beginning after December 15, 2004. Early application is encouraged. The Municipality has not adopted the requirement of this statement. Other two pronouncements are issued (GASBS Nos. 43 and 44), but do not apply to the Municipality.

END OF NOTES

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MUNICIPALITY OF HUMACAO
HUMACAO, PUERTO RICO**

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	BUDGET AMOUNTS		ACTUAL AMOUNTS (BUDGETARY BASIS) (SEE NOTE A)	VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)
	ORIGINAL	FINAL		
BUDGETARY FUND BALANCE, JULY 1, 2003	<u>\$ 5,891,479</u>	<u>\$ 5,891,479</u>	<u>\$ 5,891,479</u>	<u>\$ -</u>
Resources (Inflows):				
Property Taxes	9,552,356	9,552,356	12,898,001	3,345,645
Volume of Business Taxes	8,240,000	8,240,000	8,641,649	401,649
Intergovernmental Revenues	5,679,469	5,679,469	4,703,430	(976,039)
License and Permits	2,557,803	2,557,803	2,987,689	429,886
Miscellaneous	<u>2,555,461</u>	<u>2,555,461</u>	<u>2,631,352</u>	<u>75,891</u>
Total Resources (Inflows)	<u>28,585,089</u>	<u>28,585,089</u>	<u>31,862,121</u>	<u>3,277,032</u>
Amounts Available for Appropriation	<u>34,476,568</u>	<u>34,476,568</u>	<u>37,753,600</u>	<u>3,277,032</u>
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	1,607,829	1,816,176	1,823,333	(7,157)
General Government	14,100,739	14,405,492	14,623,791	(218,299)
Public Safety	1,966,643	1,957,205	1,945,934	11,271
Public Works	2,795,990	2,740,989	2,687,033	53,956
Health and Sanitation	2,606,449	2,980,815	2,842,262	138,553
Culture and Recreation	1,248,301	1,200,539	1,166,519	34,020
Human Services and Welfare	3,683,918	3,425,115	3,364,749	60,366
Capital Outlays	236,600	172,138	107,756	64,382
Transfer to Other Funds	<u>338,620</u>	<u>1,136,625</u>	<u>1,482,234</u>	<u>(345,609)</u>
Total Charges to Appropriations	<u>28,585,089</u>	<u>29,835,094</u>	<u>30,043,610</u>	<u>(208,516)</u>
BUDGETARY FUND BALANCE, JUNE 30, 2004	<u>\$ 5,891,479</u>	<u>\$ 4,641,474</u>	<u>\$ 7,709,990</u>	<u>\$ 3,068,516</u>

See accompanying Notes to Required Supplementary Information.

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

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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 38)	\$ 37,753,600
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.....	(5,891,479)
Prior-Year Revenue is inflows of budgetary resources but are not <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 16).....	<u>\$ 30,605,139</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 38)	\$ 30,043,610
Difference – Budget to GAAP:	
Prior-Year Expenditures are not outflows of budgetary resources but are <i>expenditures</i> for financial reporting purposes.....	398,801
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes.....	(791,961)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.....	<u>(1,482,234)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 16).....	<u>\$ 28,268,216</u>

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

Budgetary Fund Balance, June 30, 2004 (See Page 38).....	\$ 7,709,990
Timing Differences:	
Net Change in Encumbrances	(38,642)
Residual Equity Transfer	(1,036,261)
Non-budgetary Items.....	<u>(498,800)</u>
Fund Balance (See Page 14).....	<u>\$ 6,136,287</u>

END OF THIS SECTION

PART II

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND REPORTS ON COMPLIANCE AND INTERNAL CONTROL
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS
AND THE REQUIREMENTS OF OMB CIRCULAR A-133**

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

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<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>\$ 509,428</u>
U.S. Department of Housing and Urban Development:			
Community Development Block Grants/ Entitlement Grants (CDBG).....	14.218		3,620,787
Emergency Shelter Grant Program	14.231		129,899
Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	14.856		262,739
Section 8 Housing Choice Voucher	14.871		<u>1,274,409</u>
Total U.S. Department of Housing and Urban Development			<u>5,287,834</u>
U.S. Department of Justice:			
Byrne Formula Grant Program	16.579		49,478
Local Law Enforcement Block Grants Program	16.592		<u>473</u>
Total U.S. Department of Justice			<u>49,951</u>
U.S. Department of Transportation:			
Federal Transit – Capital Investment Grant	20.507		<u>1,047,527</u>
U. S. Department of Health and Human Services:			
Pass-Through Elderly Office:			
Special Programs for the Aging – Title III, Part C – Nutritional Services.....	93.045	N/AV	171,048
Pass-Through Administration of Families and Children:			
Child Care and Development Block Grant.....	93.575	N/AV	206,729
Early Head Start Program	93.600		1,260,354
Head Start Program.....	93.600	N/AV	<u>6,548,538</u>
Total U.S. Department of Health and Human Services			<u>8,186,699</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS....			<u>\$15,081,409</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

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

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

NOTE 1 BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the Municipality of Humacao, Puerto Rico, and 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's government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting which conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounts of the Municipality are presented on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for by individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

NOTE 2 CATALOG OF FEDERAL DOMESTIC ASSISTANCE ("CFDA")

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 3 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 4 MAJOR PROGRAMS

Major programs are identified in the Schedule of Findings and Questioned Costs.

END OF NOTES

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

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

We have audited the basic financial statements of Municipality of Humacao, Puerto Rico (the "Municipality") as of and for the fiscal year ended June 30, 2004, and have issued report thereon dated November 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings and Questioned Costs as items 04-01 to 04-17.

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 04-01 and 04-02.

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

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

Page 2

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.

This report is intended solely for the information and use of the Municipal Legislature, management, Office of the Commissioner of Municipal Affairs, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.


MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
November 24, 2004

Stamp number 1937245 was
affixed to the original of this
report.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL
OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

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

Compliance

We have audited the compliance of the Municipality of Humacao, Puerto Rico (the "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, 2004. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants, applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

As discussed in the accompanying Schedule of Findings and Questioned Costs listed in the Table of Contents, the Municipality did not comply with the requirements regarding cash management; eligibility; program income; procurement and suspension and debarment; reporting, and applicable special tests and provisions that are applicable to its Section 8 Housing Choice Vouchers, Community Development Block Grants/Entitlement Grants, Federal Transit Formula Grants, and Head Start. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with requirements applicable to that program.

In our opinion, except for the instances of non-compliance identified above, 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, 2004. 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.

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL
OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Page 2

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as item 04-03 to 04-17.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However we believe none of the reportable conditions described above to be material weakness.

This report is intended solely for the information and use of the Municipal Legislature, management, Office of the Commissioner of Municipal Affairs, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.


MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
November 24, 2004

Stamp number 1937246 was
affixed to the original of this
report.



PART III

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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 OMB Circular A-133? Yes No

The Municipality's major programs were:

CFDA Number	Name of Federal Program
14.218	Community Development Block Grants / Entitlement Grants
14.871	Section 8 Housing Choice Vouchers
20.507	Federal Transit Formula Grants
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B Programs: \$452,442

Auditee qualified as low-risk auditee? Yes No

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**SECTION II – FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON
THE AUDIT OF THE BASIC FINANCIAL STATEMENTS**

✓ FINDING NUMBER	04-01
DIVISION	FEDERAL FUNDS ADMINISTRATION
CATEGORY	COMPLIANCE
NONCOMPLIANCE	✓ SUSPENSIONS AND DEBARMENT
TOPIC SENTENCE	✓ Lack of controls over suspension and debarments
CONDITION	✓ The Municipality does not have procedures in place to verify the status of an entity as to suspensions and debarments when contracting services or procuring goods with federal funds. } In testing procurement, suspension and debarments, we were not able to find evidence indicating that the Municipality performs procedures to assure that the individuals and entities that receive contracts or subawards are not suspended or debarred from participation if federal programs.
CRITERIA	As stated in 24 CFR 85.35 grantee and subgrantee must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension".
CAUSE	The Municipality has no policies and procedures for the use of the List of Parties Excluded from federal procurement or non-procurement programs to assure that they do not award assistance to listed parties.
EFFECT	As a result of this deficiency, the Municipality could have procured goods or services from organizations and individuals that are suspended or debarred which could result in cost disallowances by the federal awarding agency.
RECOMMENDATION	✓ The Municipality should amend their procurement procedures and include a step to verify whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and no procurement programs. The Municipality should also require the entities or individuals to submit a certification stating that they are not suspended or debarred.
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER 04-02

DIVISION FEDERAL FUNDS ADMINISTRATION

CATEGORY INTERNAL CONTROLS OVER COMPLIANCE

NONCOMPLIANCE ✓ PROCUREMENT

TOPIC SENTENCE ✗ Contracts lack of required Federal provisions

CONDITION

As part of the evaluation of contracts granted to individuals and entities from which the Municipality procured goods and services, we selected 13 contracts. Our test revealed that 13 out of 13 (100%) contracts examined does not contain a provision regarding compliance with executive order 11246 of September 24, 1965, entitled "Equal Employment Opportunity"; and retention of all required records for three years after grantees or subgrantees make final payments and all other pending matters are closed.

We also noted that contract files do not contain all requested documents before a contract is granted as follows:

<u>Documents</u>	<u>Amount</u>
- Resolution regarding signature authorization	13
- Public Responsibility Insurance	4
- Unemployment and Disability Insurance	2
- Certificate of Incorporation	2
- Copy of audited or compiled financial statements	1
- "Fondo del Seguro del Estado" Insurance Policy	1

CRITERIA

As stated in 24 CFR 85.36(i) (3) (11) a grantee's and subgrantee's contracts must contain, among others, a provision regarding compliance with executive order 11246 of September 24, 1965, entitled "Equal Employment Opportunity"; and retention of all required records for three years after grantees or subgrantees make final payments and all other pending matters are closed.

CAUSE

The Municipality has not ensured that all contracts granted counts with the required provisions due to the lack of understanding of the applicable Federal regulation.

EFFECT

Contracts failure to contain all required federal provisions could expose the Municipality of being liable for contractors' non compliance with applicable federal laws and regulations contained within the required provisions.

RECOMMENDATION

The Municipality should verify and amend their contracts in order to include all required provisions as required by Federal regulations.

QUESTIONED COSTS NONE

MANAGEMENT RESPONSE Pending the Corrective Action Plan.

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**SECTION III – FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO FEDERAL PROGRAMS**

SECTION 8 HOUSING CHOICE VOUCHERS – CFDA 14.871

The Housing choice Voucher Program (HCVP) provides rental assistance to help very low income families afford decent, safe, and sanitary rental housing. The HCVP is administered by local public housing agencies (PHA's) authorized under State law to operate housing programs within an area or jurisdiction. The PHA accepts the application for rental assistance, selects the applicant for admission, and issues the selected family a voucher confirming the family's eligibility for assistance. The family must then find and lease a dwelling unit suitable to the family's needs and desires in the private rental market. The PHA pays the owner a portion of the rent (a housing assistance payment (HAP)) on behalf of the family.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with the requirements applicable to the Section 8 Housing Choice Vouchers federal financial assistance program.

FINDING NUMBER	04-03
CATEGORY	COMPLIANCE
NONCOMPLIANCE	✓ CASH MANAGEMENT
TOPIC SENTENCE	Non-Compliance with cash management requirement (Prior Report Finding Number 03-III-02)
CONDITION	<p>Section 8 Housing Choice Voucher Program does not have adequate controls over the timing of disbursements once the federal funds are received.</p> <p>During the fiscal year 2003-2004, the Municipality received \$939,096 from Section 8 Voucher grant funds. In order to determine compliance with cash management requirement, we selected for testing one of the twelve remittances amounting \$139,951 (15%). The time elapsed between the receipt and the disbursement of such funds was for more than three months. We also noted that during the fiscal year 2003-2004, the Program maintained a monthly bank account balance between \$371,400 and \$67,000 before next monthly deposit.</p>
CRITERIA	As stated in 24 CFR 85.21 and 31 CFR 205.33, Subpart B, grantees must minimize the time elapsing between the drawdown of Federal funds from the Federal government and their disbursements for Federal program purposes.
CAUSE	Monthly deposits transferred by HUD are supported by an annual contribution contract based on an estimated number of occupied units and annual payments to owners. Due to the non identification of available dwelling units within the Humacao territory, the Program counts with a number of vouchers much higher than the amount of dwelling units available for rent. Such situation causes that, even when the Program counts with the necessary funds to provide housing assistance, these could not be expended due to the lack of units to be rented.
EFFECT	If the recipient fails to expend those Federal assistance funds within a reasonable period or fails to establish procedures to minimize the time elapsing between cash advances and the disbursements, the Municipality could be adversely affected in the benefits they are entitled to receive in the future.
RECOMMENDATION	The Program should implement adequate internal control procedures which allow the promptly use of federal funds received through the payment of rent to the owners. This could be attained through the identification of dwelling units ready for occupancy once the vouchers are granted.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER	04-04
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	PHA is not following admission policies according to the administrative plan
CONDITION	Applications received by Section 8 Housing Choice Voucher Program were not selected from the waiting list in accordance with Public Housing Authority ("PHA") administrative plan. According to Program's administrative plan applications should be selected according to date and time received. After reviewing the waiting list, we noted that applications that were received at last were attended before those previously received. Also, vouchers were granted among those families who submitted such applications at last.
CRITERIA	As stated in 24 CFR 982.204(a); except for special admissions, PHA must select participants from the waiting list in accordance with admission policies in the PHA administrative plan. Program's administrative plan establishes no preferences for admission to Section 8 tenant-based assistance. Applications should be entered into a pool and selected according to date and time received.
CAUSE	With the purpose of sustain an adequate occupancy level, HUD officials authorized the Program to grant vouchers among applicants, on a first-in first-serve basis, indistinct the date or time in which the application was received and registered into the waiting list.
EFFECT	Selection process from the waiting list could be questioned by legating preference among applicants. Such lack of control, also, could cause that ineligible participants could be admitted into the Program cause costs disallowance.
RECOMMENDATION	As an adequate control measure, the Program should encourage that all policies and procedures, as the one established in the administrative plan regarding admission selection from the waiting list, should be followed unless there is a major cause for the contrary.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER	04-05
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	Rents amounts paid were not in accordance to PHA administrative plan
CONDITION	<p>Rent amounts paid to owners of Section 8 Housing Choice Voucher Program's dwelling units, were not in accordance with Public Housing Authority ("PHA") administrative plan. According to the PHA administrative plan, the amount of rent to be paid to owners should be 100% of the fair market rent based on HUD effective tables.</p> <p>In order to test compliance with such policy, we selected for testing 40 participants/owners files. In six out of 40 (15%) participant files examined, we found evidence which reflects that the amount of rent that the Program was paying to the owners was below or higher to HUD's 100% fair market rent.</p> <p>After evaluating internal controls over compliance with reasonable rent determination, we noted that three out of 40 (7%) participants files does not include an internal form used by the Program to determine expected owners rent amount entitled "Solicitud de Aprobación de Arrendamiento". In addition, in 12 out of 37 files (30%) examined, we noted that the rent to owner amount as per HUD Form 50058 differ from the amount of rent which was requested by the owners through the "Solicitud de Aprobación de Arrendamiento".</p>
CRITERIA	<p>The foregoing condition is not in accordance with 24 CFR 982.54(d)(15) which establishes that the PHA administrative plan must cover PHA policies regarding the method of determining that rent to owner is a reasonable rent (initially and during the term of a HAP contract). In addition, 24 CFR 982.153(b)(13) establishes that in administering the program, the PHA must determine the maximum rent to the owner, and whether the rent is reasonable.</p>
CAUSE	<p>HUD representatives authorized the Program to increase the amount of rent it was paying to the owners since amounts were paying were below the effective fair market rent as per HUD tables. For such reason, the Program decided to pay a rent amount higher than the one requested by the owners and the one established on the administrative plan.</p>
EFFECT	<p>The Municipality might be making payments in excess or below the established fair market rent amounts. Also, it could adversely affect the Municipality's ability to be awarded with future grants.</p>
RECOMMENDATION	<p>The Program should follow the methods established in the administrative plan regarding reasonable rent determination and rent amounts to be paid to owners. If a different practice is follow, PHA administrative plan should be amended and informed to HUD.</p>
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER	04-06
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	Utilities allowances amounts were not properly supported
CONDITION	In connection with the special test regarding utility allowances, we found that in six out of 40 (15%) participants files selected for testing, lack of evidence supporting utilities allowance amounts considered as part of the rent calculation on form HUD 50058. In addition, in three out of 40 (7%) participants' files, we found that the utility allowance amount indicated on form HUD 50058 does not agree with the amount determined by the Program personnel.
CRITERIA	As stated in 24 CFR 85.20(b)(2) and (6), grantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities. Records must be supported by source documentation.
CAUSE	This condition arise because, in occasions, Section 8 Housing Choice Vouchers program personnel forget to follow, gather and obtain all the necessary documents that support allowance amounts as per HUD form 50058.
EFFECT	Lack of evidence supporting utility allowance amount could cause that housing assistance payment ("HAP") amount be incorrectly calculated. As a consequence, paid rent amounts, negative rent amounts or rent to owner amounts could be incorrect causing cost disallowances by the federal awarding agency.
RECOMMENDATION	The Municipality's management should revise its internal control procedures to obtain and include in the participant files all the necessary information that support amounts presented in HUD form 50058.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER	04-07
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	Non-Compliance with Housing Quality Standards Inspections and Enforcement
CONDITION	<p>In connection with the special test regarding Housing Quality Standards ("HQS") inspections and enforcement, we selected for testing 10 program unit files. Our test revealed the following:</p> <ul style="list-style-type: none"> - Internal controls implemented by the Program regarding HQS were not adequately followed. Four out of nine (44%) files of units failing to meet HQS does not contain evidence which demonstrate that deficiencies were communicated to the owner through a report or a letter; - Two out of 10 (20%) files selected for testing contain evidence which demonstrate that inspections and HQS checklists were performed and completed, the same date, or the day after the participant was admitted to the Program, respectively; - Seven out of nine (78%) files of units failing to meet HQS does not contain evidence which demonstrate that the Program is enforcing units owners to correct deficiencies within 30 calendar days or within any specified extension approved by them; - The Municipality is not taking immediate action to enforce owners or families to correct the deficiencies determined within a specified period of time. Five out of nine (56%) files of units failing to meet HQS were re-inspected 31 to 119 days after the first inspection, and in two of those cases, repairs were completed after 22 to 68 additional days.
CRITERIA	<p>The above conditions are not in compliance with 24 CFR 982.401(a)(3); 982.404 (a)(3); 982.405(d) and 982.406 which establishes that all program housing must meet the HQS performance requirements both at commencement of assisted occupancy, and throughout the assisted tenancy. The PHA must not make any housing assistance payments for a dwelling unit that fails to meet the HQS, unless the owner corrects the defect within the period specified by the PHA and the PHA verifies the correction. If a defect is life threatening, the owner must correct the defect within no more than 24 hours. For other defects, the owner must correct the defect within no more than 30 calendar days or any PHA-approved extension. The PHA must notify the owner of defects shown by the inspection and HQS should be enforced by the PHA.</p>
CAUSE	<p>The Program is recently implementing procedures and obtaining the necessary resources to ensure compliance, in full, with housing quality standards enforcement regulations.</p>
EFFECT	<p>The Municipality might be making payments for sub-standard housing units and participants might be adversely affected in the benefits they are entitled to receive.</p>
RECOMMENDATION	<p>The Program should continue enhancing its housing quality standards enforcement procedures to ensure that timely follow up on failed inspection is preformed and, thus, to effectively monitor compliance with housing quality standards enforcement regulations.</p>

QUESTIONED COSTS None

MANAGEMENT RESPONSE Pending the Corrective Action Plan.

FINDING NUMBER 04-08

CATEGORY INTERNAL CONTROLS OVER COMPLIANCE

NONCOMPLIANCE ELIGIBILITY

TOPIC SENTENCE Participants files lack of required documentation (Prior Report Finding Number 03-III-01)

CONDITION

In testing internal controls over compliance, we selected 40 participants files to determine if the Program's implemented policies were been followed in order to avoid that ineligible participants could be admitted into the Program. Among those implemented procedures, applicants are requested to provide various documents. Our test revealed that 37 out of 40 (93%) participant files do not contain at least one of the following documents:

<u>Documents</u>	<u>Quantity</u>
Release information consent	21
Third party income verification	3
Participants application form	3
Social security copies	7
Employment verification	2
Evidence of rent paid before be admitted into the Program	19
Marriage or divorce certificate	9
Birth certificate copies	4
Good conduct certificate from PR Police Department	10
Dependents student certificate	3
Negative certification from the PR Treasury Department	2
Negative certification from the PR Unemployment Department	4
Family picture	1
Negative certification from "CRIM" (Real and personnel property tax)	2
Affidavit regarding family composition and income	4
Evidence of utilities paid	7
Evidence of social security benefits	24
Housewife certificate	10
Negative certification from "ASUME"	4

CRITERIA The above condition is not in compliance with 24 CFR 85.20(3); 982.201(e) and 982.516 which establishes that effective controls must be maintained for all grant financed activities. The PHA must receive information verifying that an applicant is eligible within the period of 60 days before the PHA issues a voucher to the applicant.

CAUSE This condition arises because during participant admission and renewal process, applicants are not providing to the Program with all the required documents. Thereafter, Program personnel is forgetting to follow up and obtaining those documents which were not provided by the participants before they are admitted or re-admitted into the Program.

EFFECT Failure to obtain all required documentation as part of participant's eligibility determination may result in the possibility of not preventing, detecting and correcting, on a timely basis, significant instances of noncompliance that may expose the Municipality to cost disallowances.

RECOMMENDATION The Program should obtain all required documents before a participant is admitted or re-admitted into the Program. They should also conduct periodic monitoring and follow up procedures that allow them to ensure that all required documents are obtained during the admission process and throughout the year.

QUESTIONED COSTS **None**

MANAGEMENT RESPONSE **Pending the Corrective Action Plan.**

FINDING NUMBER	04-09
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	Housing Assistance Payment (HAP) amounts were incorrectly calculated
CONDITION	<p>Of the 92 program participants receiving housing assistance during the fiscal year 2003-2004, we selected 40 participants files (43%) to evaluate participants income eligibility, total tenant payment and housing assistance payment ("HAP") amounts. The test revealed the following:</p> <ul style="list-style-type: none"> - In 36 cases (90%), payment standard amounts (PSA) considered as part of HAP determination (HUD Form 50058) were incorrect and not in accordance with what it was established by Program's administrative plan (100% of fair market rent). - In 11 participants files (28%) we found income evidence which was not considered as part of participants HAP determination (HUD Form 50058). - Five participants' files (13%) do not include evidence that justify child support or elderly/disability allowances considered on HUD Form 50058. - Total tenant payment ("TTP") amounts considered as part of five participants' HAP determination (HUD Form 50058) were incorrect. - HAP determination related to one participant (3%) does not consider any amount as TTP. As per Program's administrative plan \$25 has been established as the minimum TTP.
CRITERIA	The foregoing conditions are not in accordance with 24 CFR 982.54(d)(14) which establishes that the PHA administrative plan must cover PHA policies regarding the process for establishing and revising payment standards, including affordability adjustment.
CAUSE	<p>The reasons for the ongoing conditions are the following:</p> <p>Regarding income evidence not considered for purpose of determining TTP, HAP and participant's eligibility, the Program decided not to consider those amounts which participants are entitle to receive, such as child support, if such amounts are not being received by the participant for a reasonable period of time.</p> <p>Program personnel is not following, gathering and obtaining all the required documents that support amounts indicated on form 50058.</p> <p>HUD forms 50058 are not double checked once they are electronically generated by a mechanism system (LIVING SYSTEM) in order to determine any mistake made at the moment when the information was entered into the system.</p>
EFFECT	Housing assistance payment (HAP) amount could be incorrectly determined by considering an amount not properly supported or incorrectly determined. The Program might be making payments in excess or below the corresponding HAP amount that may expose the Municipality to cost disallowance and adversely affect the Municipality's ability to be awarded with future grants.
RECOMMENDATION	At the moment of determining HAP and TTP amounts, Program personnel should adhere to the policies and procedures established by HUD approved

Program's Administrative Plan. The Program should also revise its internal control procedures to obtain, and include in the participant files, all the necessary information that support amounts indicated on HUD 50058 forms. The implementation of a new electronic system supported by HUD should be considered.

QUESTIONED COSTS

None

MANAGEMENT RESPONSE

Pending the Corrective Action Plan.

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

COMMUNITY DEVELOPMENTY BLOCKS GRANT - CFDA 14.218

The primary objective of the Community Development Block Grant (CDBG) Entitlement Program (large cities) is to develop viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with the requirements applicable to the CDBG federal financial assistance program.

FINDING NUMBER	04-10
CATEGORY	INTERNAL CONTROLS OVER COMPLIANCE
NONCOMPLIANCE	CASH MANAGEMENT / PROGRAM INCOME
TOPIC SENTENCE	Non-Compliance with cash management requirement and program income disposition (Prior Report Finding Number 03-III-02)
CONDITION	<p>Community Development Blocks Grant Program ("CDBG") accounting records do not provide sufficient information to determine compliance with the cash management requirement and program income disposition.</p> <p>In order to determine compliance with cash management requirement, we verified CDBG's general ledger and check register. We noted that deposits and expenditures of CDBG grant funds, CDBG program income and Disaster Recovery Initiative Program ("DRI") grant funds were grouped as one and accounted for in a single general ledger account. In addition, all deposits and expenditures from the three different sources of funds were made through a single bank account. As a consequence tracking could not be maintained over the type and amount of expenditures that were charged against each federal grant award; preventing us of properly determine the time elapsed between the receipt and the disbursement, specifically, of CDBG grant funds.</p> <p>We also could not determine if program income was disposed of before additional cash withdrawals are made from the US Treasury.</p>
CRITERIA	<p>As stated in 24 CFR 85.20 (a) and (b) (2) fiscal control and accounting procedures of the grantees and subgrantees must be sufficient to permit preparation of reports required by this part and the statues authorizing the grant, and permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restriction and prohibitions of applicable statues. Grantees and subgrantee must maintain records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.</p> <p>24 CFR 85.21(f)(2) grantees and subgrantees shall disburse program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.</p> <p>24CFR 570.504(2) (ii) program income shall be disbursed for eligible activities before additional cash withdrawals are made from the US Treasury.</p>
CAUSE	There is an understanding that CDBG funds, program income and DRI funds accountability could not be segregated, nor a separate bank account could be maintained for DRI grant funds.
EFFECT	The lack of segregation of receipts and expenditures between federal grant awards neither allow to ensure compliance with the cash management and program income disposition requirement nor permit to evaluate that compliance through and audit or review. If the recipient fails to expend those Federal assistance funds within a reasonable period or fails to establish procedures to minimize the time elapsing between cash advances and the disbursements, the Municipality could be adversely affected in the benefits they are entitled to receive in the future.
RECOMMENDATION	In order to monitor and determine compliance with applicable cash management requirements and program income disposition, CDBG program should

implement adequate internal control procedures which allow proper identification and accountability of funds sources and expenditures.

QUESTIONED COSTS

None

MANAGEMENT RESPONSE

Pending the Corrective Action Plan.

FINDING NUMBER	04-11									
CATEGORY	COMPLIANCE									
NONCOMPLIANCE	REPORTING									
TOPIC SENTENCE	Financial Summary (CO4PR26) amounts does not agree with general ledger									
CONDITION	<p>Community Development Blocks Grant ("CDBG") Financial Summary (CO4PR26) report does not agree with the Program's general ledger.</p> <p>During our reporting test, we found that Program's Financial Summary reported expenditures does not agree with the general ledger kept at the Program as follows:</p> <table border="0"> <tr> <td style="text-align: center;">Total Expenditures</td> <td style="text-align: center;">Expenditures</td> <td></td> </tr> <tr> <td style="text-align: center;"><u>Reported</u></td> <td style="text-align: center;"><u>Per Books</u></td> <td style="text-align: center;"><u>Difference</u></td> </tr> <tr> <td style="text-align: center;">\$3,037,342</td> <td style="text-align: center;">\$3,367,972</td> <td style="text-align: center;">\$330,630</td> </tr> </table>	Total Expenditures	Expenditures		<u>Reported</u>	<u>Per Books</u>	<u>Difference</u>	\$3,037,342	\$3,367,972	\$330,630
Total Expenditures	Expenditures									
<u>Reported</u>	<u>Per Books</u>	<u>Difference</u>								
\$3,037,342	\$3,367,972	\$330,630								
CRITERIA	As specified in 24 CFR 85.20(b) (1), accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant.									
CAUSE	The Program personnel has stated that this report is automatically generated by the Integrated Disbursement and Information System ("IDIS") and is not reconciled against numbers kept at the program level or the number in the Municipality's general ledger.									
EFFECT	The continuous occurrence of this situation inhibits the federal awarding agency from monitoring the programs financial performance. In addition, the Program could be sanctioned by the federal awarding agency due to the inaccurate filing of financial reports.									
RECOMMENDATION	The Municipality should perform timely reconciliation and cutoff procedures between numbers kept at the federal programs and numbers recorded in the general ledger in order to provide reasonable assurance that reports of federal awards submitted to the federal awarding agency include all activity of the reporting period, are supported by underlying accounting or performance records, and are fairly presented in accordance with program requirements.									
QUESTIONED COSTS	NONE									
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.									

FINDING NUMBER 04-12

CATEGORY COMPLIANCE

NONCOMPLIANCE PROCUREMENT

TOPIC SENTENCE Non-Compliance with procurement procedures

CONDITION In testing procurement, we selected 14 files to review that procurement procedures were follow according to applicable Federal and Municipality laws and regulations.

In February 2004, an auction was celebrated for the pavements and repavement of rural and urban zones within the Municipality of Humacao (Num. 03-04-27). The auction was adjudged among four of the bidders which presented an offer. Community Development Block grants funds obligated for such works amount to \$982,895. In relations to such auction we determined the following:

- Bids were publicly solicited through a public notice which was published eight days before the auction date, and not 10 days before, as established by Municipalities Law.
- Bid bond presented by each bidder was for a standard amount of \$400 and not by a five percent of the bid price as indicated in the published auction notice.
- Bidders were not provided with complete, adequate and detail information regarding the scope and locations of the work. This situation unallows bidders to present an adequate quotation, and force them to present a quotation based on a price per square or cubic meter. As a consequence, the auction could be considered irrelevant since it was adjudged among four bidders and not to the one which presented the lower price per square or cubic meter.
- The auction file does not contain a detail report which evidences the rationale method for selection or rejection of contractors, nor the reasons for adjudging such auction among four different contractors.

We also noted that in two out of the 14 auction files examined, offers were received from companies that were not included on the Municipality's bidders register ("Registro de Licitadores") as required by the Municipalities Law. In addition, one additional bidder from one out of the 14 auctions examined did not present a bid bond.

CRITERIA According to Chapter VIII, Part III, Section 2 of the Basic Standards for the Municipalities of Puerto Rico bids must be publicly solicited through a newspaper of general circulation with no less than 10 days before the auction date.

As stated in 24 CFR 85.36 (h)(1) for construction or facility improvements contracts, grantee or subgrantee, as a minimum, shall request from each bidder a bid guarantee, such as bid bond, certified check, or other negotiable instrument, equivalent to five percent of the bid price.

24 CFR 85.36 (b) (9) grantee and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

24 CFR 85.36 (c)(4) grantee and subgrantees will ensure that all prequalified lists of persons, firms, or products which are used in acquiring goods and

services are current and include enough qualified sources to ensure maximum open and free competition..

CAUSE

The aforementioned conditions were caused by the accelerated procedures that were followed by the Municipality in order to complete such works, draw down and spend the CDBG grant funds, and at the same time, meet the 1.5 timeliness standard by May 2004.

EFFECT

As a result of these deficiencies, the Municipality could procure goods or services and not ensuring a maximum open and free competition in order to be benefited from the best offer. Also, lack of bonding guarantees could expose the Municipality to contractor's noncompliance. These conditions could result in cost disallowances by the federal awarding agency.

RECOMMENDATION

Procurement process should ensure maximum open and free competition by publicly soliciting offers from bidders by at least ten days before the auction date. Once the auction has been celebrated, the Municipality should maintain records sufficient to detail the significant history of the procurement by detailing the rationale method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

As part of the procurement process, the Municipality should assure that all bidders provide to the Municipality with all the required bonding guarantees according to the applicable Municipal and Federal laws and regulations.

QUESTIONED COSTS

NONE

MANAGEMENT RESPONSE

Pending the Corrective Action Plan.

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

FEDERAL TRANSIT – FORMULA GRANTS (Urbanized Area Formula Program) - CFDA 20.507

The objectives of the Federal Transit – Urbanized Area Formula Grants (49 USC 5307) programs are to assist in financing the planning, acquisition, construction, preventative maintenance, and improvement of facilities and equipment in mass transportation services.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with the requirements applicable to the Federal transit federal financial assistance program.

FINDING NUMBER	04-13
CATEGORY	COMPLIANCE
NONCOMPLIANCE	CASH MANAGEMENT
TOPIC SENTENCE	Non-Compliance with cash management requirement
CONDITION	<p>The Federal Transit Formula Grant Program ("FTA") does not have adequate controls over the timing of disbursements once the federal funds are received.</p> <p>During the fiscal year 2003-2004, the Municipality received \$1,136,700 from FTA funds. In order to determine compliance with cash management requirement, we selected for testing two out of the nine FTA remittances amounting \$1,001,894 (88%). In two out of two (100%) of the monthly remittances selected for testing, the time elapsed between the receipt and the disbursement of such funds was from 42 to 65 days.</p>
CRITERIA	<p>As stated in 49 CFR 18.21; 31 CFR 205.33, Subpart B; and FTA Master Agreement Section 9(b) (1)(a); grantees and subgrantees must minimize the time elapsing between the drawdown of Federal funds from the Federal government and their disbursements for Federal program purposes. The recipient may draw down cash only when actually needed for immediate disbursement required for Project purposes. The recipient agrees to expend all Federal funds obtained under the Project for Project purposes no later than three (3) days after receiving those funds..</p>
CAUSE	<p>Erroneously FTA Program request to the Federal Government an amount equal to the total eligible cost, local (\$120,000) and FTA (\$480,000) share amount, regarding the design and construction of busway (project 11.21.01 and 11.23.01).</p>
EFFECT	<p>If the recipient fails to expend those Federal assistance funds within three (3) days of receipt, fails to return those funds to FTA within a reasonable period, or fails to establish procedures to minimize the time elapsing between cash advances and the disbursements, the Federal Government may revoke or temporarily suspend the recipient's ECHO control number and the recipient's access to the ECHO system. In addition, a recipient's failure to adhere to these requirements may result in other remedies or penalties authorized by the Federal law or regulation.</p>
RECOMMENDATION	<p>The Program should implement adequate internal control procedures which allow the promptly use of federal funds received. The recipient should draw down funds only when actually needed for immediate disbursement. Any requested amount in excess of immediate needs should be immediately returned to the Federal government.</p>
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER	04-14
CATEGORY	COMPLIANCE
NONCOMPLIANCE	PROCUREMENT
TOPIC SENTENCE	Deficiencies in the procurement process
CONDITION	<p>In testing procurement, we examined the procurement procedures followed by the Municipality regarding the busway and maintenance garage facilities constructions, and the acquisition of a bus / rolling stock. Upon examination we noted the following:</p> <p>(a) In September 2003 and April 2004, the Municipality celebrated the auctions related to the acquisition of a bus / rolling stock and the design and construction of a maintenance garage facility without counting with the 20% local share needed to complete projects costs. As a consequence, auctions were not adjudged and FTA financial assistance awarded by \$484,000 (PR-90-X177-00) remains available for use since October 2001.</p> <p>(b) In September 2002, the Municipality celebrated an auction for the engineering, design and construction of a busway. A month later the auction was adjudged and in December 2002 a private company was contracted by \$3,647,675. Per contract granted; project total costs will be financed through FTA financial assistance (PR-90-X165-01) and local share of \$2,228,000 and \$1,419,675, respectively. During the course of our audit, we found that FTA financial assistance awarded was \$1,355,000; \$873,000 less than the amount of funds indicated in the contract and incorrectly appropriated on the accounting records.</p>
CRITERIA	<p>As stated in 49 CFR 18.24 and FTA Master Agreement Section 5 (a) and (b) the recipient agrees to provide sufficient funds or approved in-kind resources that, together with the Federal financial assistance awarded, will assure payment of the actual cost of the each Project activity covered by the Grant Agreement or Cooperative Agreement. In addition the recipient agrees to complete all proceedings necessary to provide the local share of the Project costs at or before the time those funds are needed to meet Project expenses.</p> <p>FTA Master Agreement Section 9 (a) establishes that to obtain a Federal assistance payment for the Project from FTA, the recipient agrees to demonstrate or certify that it will provide adequate local funds that, when combined with Federal payments, will cover all costs to be incurred for the Project.</p> <p>According to Chapter VIII, Part III, Section 1, of the Basic Standards, the Municipality cannot publicly solicit bids until funds are properly identified and obligated.</p>
CAUSE	The first situation occurred because the Municipality does not count with the funds needed to comply with the 20% local share requirement. The second condition was caused by an overstatement in the estimated amount of funds to be awarded from FTA.
EFFECT	<p>The first condition could lead to the loss of funds due to noncompliance with 1 local share requirement established by federal regulations.</p> <p>The second condition caused that the Municipality incurred expenditures of approximately \$44,164 in excess of the Federal financial assistance awarded by FTA. This could result in possible limitations on available funds and the</p>

eventual reduction of municipal services since future revenues will need to be used to pay for accumulated liabilities.

RECOMMENDATION

The Municipality's management should implement controls to prevent expenditures in excess of revenues or Federal financial assistance. Management should review unencumbered balances for each appropriation. This will provide the Budgeting Division with the necessary information to prevent the issuance of purchase orders or contracts for which funds are not currently available.

QUESTIONED COSTS

NONE

MANAGEMENT RESPONSE

Pending the Corrective Action Plan.

FINDING NUMBER	04-15
CATEGORY	COMPLIANCE
NONCOMPLIANCE	REPORTING
TOPIC SENTENCE	Financial Status reports does not agree with the Program's general ledger
CONDITION	<p>During our reporting tests, we found that the Municipality filed PR-90-X149-01, PR-90-X177-00, PR-90-X193-00 and PR-90-X165-01 Quarterly Narrative Reports that does not agree with the Program's general ledger or any other accounting record.</p> <p>Amounts reported as part of the quarterly Financial Status Reports could not be traced to Program's accounting records or any other document which support such amounts. In addition, differences were also noted between the amounts per Municipality's accounting records and the ones per Program's internal accounting records.</p>
CRITERIA	As per 49 CFR 18.20 (b) (1) and (2), accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities.
CAUSE	Quarterly Financial Status reports are being completed by the Program personnel by using a purchase order and a check register report provided by the Municipality's Finance Division. Such reports are not agreed nor verified against Program's general ledger and accounting records for any reconciling item. Once they are used reports are not maintained.
EFFECT	The continuous occurrence of this situation inhibits the federal awarding agency from monitoring the programs financial performance. In addition, the Program could be sanctioned by the federal awarding agency due to the inaccurate filing of financial reports.
RECOMMENDATION	The Municipality should perform timely reconciliation and cutoff procedures between numbers kept at the federal programs and numbers recorded in the general ledger in order to provide reasonable assurance that reports of federal awards submitted to the federal awarding agency include all activity of the reporting period, are supported by underlying accounting or performance records, and are fairly presented in accordance with program requirements.
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

FINDING NUMBER	04-16
CATEGORY	INTERNAL CONTROLS OVER COMPLIANCES
NONCOMPLIANCE	PROCUREMENT
TOPIC SENTENCE	Contracts lack of required Federal provisions
CONDITION	<p>In testing contracts, we selected the contract granted for the construction of the busway.</p> <p>Our test revealed that the contract does not contain a provision regarding compliance with: executive order 11246 of September 24, 1965, entitled "Equal Employment Opportunity" and retention of all required records for three years after grantees or subgrantees make final payments and all other pending matters are closed.</p>
CRITERIA	As per 49 CFR 18.36 (i) a grantee's and subgrantee's contracts must contain, among others, a provision regarding compliance with executive order 11246 of September 24, 1965, entitled "Equal Employment Opportunity"; and retention of all required records for three years after grantees or subgrantees make final payments and all other pending matters are closed.
CAUSE	The Municipality has not ensured that all contracts granted counts with the required provisions due to the lack of understanding of the applicable Federal regulation.
EFFECT	Contracts failure to contain all required federal provisions could expose the Municipality of being liable from contractor non compliance with applicable federal laws and regulations contained within the required provisions.
RECOMMENDATION	The Municipality should verify and amend their contracts in order to include all required provisions as required by Federal regulations.
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

HEAD START - CFDA 93.600

The objectives of the Head Start and Early Head Start programs are to provide comprehensive health, educational, nutritional, social and other development services primarily to economically-disadvantaged preschool children (age 3 to 5) and infants and toddlers (birth through age 3) so that the children will attain school readiness. Parents receive social services and participate in various decision-making processes related to the operation of the program.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with the requirements applicable to the Head Start federal financial assistance program.

FINDING NUMBER	04-17
FEDERAL PROGRAM	HEAD START (CFDA 93.600) U. S. DEPARTMENT OF HEALTH AND HUMAN
NONCOMPLIANCE	CASH MANAGEMENT
TOPIC SENTENCE	Non-Compliance with cash management requirement
CONDITION	Head Start Program does not have adequate controls over the timing of disbursements once the federal funds are received. During the fiscal year 2003-2004, the Municipality received \$7,748,415 from Head Start grant funds. In order to determine compliance with cash management requirement, we selected for testing five deposits amounting \$2,146,309 (28%). The time elapsed between the receipt and the disbursement of such funds was from 14 to more than 30 days.
CRITERIA	As stated in 24 CFR 85.21 and 31 CFR 205.33, Subpart B, grantees must minimize the time elapsing between the drawdown of Federal funds from the Federal government and their disbursements for Federal program purposes.
CAUSE	It takes few days since payments vouchers and related supporting documentation is prepared and gathered at the Program level and it is finally reviewed, authorized and paid by the corresponding finance divisions within the Municipality.
EFFECT	If the recipient fails to expend those Federal assistance funds within a reasonable period or fails to establish procedures to minimize the time elapsing between cash advances and the disbursements, the Municipality could be adversely affected in the benefits they are entitled to receive in the future.
RECOMMENDATION	The Program should implement adequate internal control procedures which allow the promptly use of federal funds received through the payment of rent to the owners. This could be attained through the identification of dwelling units ready for occupancy once the vouchers are granted.
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

END OF SCHEDULE

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

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

FOR THE YEAR ENDED JUNE 30, 2004

The following schedule contains the finding number, title; questioned costs and status of each of the findings included in the schedule of findings and questioned costs relative to federal awards for the year ended June 30, 2003 as required by OMB Circular A-133.

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

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

FOR THE YEAR ENDED JUNE 30, 2004

FISCAL YEAR	FINDING NUMBER		CFDA NUMBER	QUESTIONED COST	COMMENTS
2003	03-III-01	Special Tests and Provisions	14.871	NONE	Situation still prevails. Refer to Finding Num 04-08.
	03-III-02	Cash Management – Excess Cash Balance	14.218 / 14.856 / 14.871	NONE	Situation still prevails. Refer to Finding Num 04-03 and 04-10.

END OF SCHEDULE