

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

MUNICIPIO DE LARES
AUDITORIA 2003-2004
30 DE JUNIO DE 2004

MUNICIPALITY OF LARES, PUERTO RICO
SINGLE AUDIT REPORT
FISCAL YEAR ENDED JUNE 30, 2004

Case No. 1-5730

MUNICIPALITY OF LARES, PUERTO RICO
SINGLE AUDIT REPORT
FISCAL YEAR ENDED JUNE 30, 2004

CONTENTS

FINANCIAL SECTION	PAGE
Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-10
Basic Financial Statements	
Government-wide Financial Statements:	
Statement of Net Assets	11
Statement of Activities	12
Fund Financial Statements:	
Balance Sheet-Governmental Funds	13-14
Statement of Revenues, Expenditures, and Changes in Fund Balance-Governmental Funds	15-16
Notes to the Basic Financial Statements	17-38
Required Supplementary Information	
Budgetary Comparison Schedule – General Fund	39
Note to Budgetary Comparison Schedule – General Fund	40
 SINGLE AUDIT SECTION	
Schedule of Expenditures of Federal Awards	41
Notes to Schedule of Expenditures of Federal Awards	42-43
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	44-45
Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and On Internal Control Over Compliance in Accordance with OMB Circular A-133	46-47
Schedule of Findings and Questioned Costs	48-54
Summary Schedule of Prior Audit Findings	55

MUNICIPALITY OF LARES, PUERTO RICO

FINANCIAL SECTION

YEAR ENDED JUNE 30, 2004



The CPA. Never Underestimate The Value.

ROMAN TORO & CO., CSP
Certified Public Accountants and Business Consultants

Members of:

American Institute of Certified Public Accountants
Puerto Rico Society of Certified Public Accountants

Partners:

Juan E. Román Toro, MBA, CPA
José D. Román Toro, CPA

INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Members of the
Municipal Assembly
Municipality of Lares, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Lares, Puerto Rico**, as of and for the year ended June 30, 2004, which collectively comprise the Municipality of Lares, Puerto Rico's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of Lares, Puerto Rico's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

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 of Lares, Puerto Rico, as of June 30, 2004, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2005, on our consideration of the Municipality of Lares, Puerto Rico's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 3 through 10 and 39 through 40, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

INDEPENDENT AUDITOR'S REPORT

(CONTINUED)

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Lares, Puerto Rico basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of Municipality of Lares, Puerto Rico. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.


ROMAN TORO & CO., CSP
LICENSE #35 - IN FORCE

Yauco, Puerto Rico
March 21, 2005

Stamp #2038069 was affixed to
the original of this report

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

Management of the **Municipality of Lares, Puerto Rico (Municipality's)** discussion and analysis is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the **Municipality's** financial activity, (c) identify changes in the **Municipality's** financial position (its ability to address the next and subsequent year challenges), (d) identify any material deviations from the financial plan (the approved budget, and (e) identify individual fund issues or concerns. This narrative overview and analysis of the financial activities of the **Municipality** is for the fiscal year ended June 30, 2004. We encourage readers to consider this information with the **Municipality's** basic financial statements that follow.

Because the **Municipality** is implementing new reporting standards for this fiscal year with significant changes in content and structure, 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 not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the **Municipality's** financial position and results of operations.

FINANCIAL HIGHLIGHTS

Government-wide:

The **Municipality's** net assets decreased by \$680 thousand (or 8%).

The governmental activities revenue for the General Fund increased by \$1.1 million (or 14%).

Fund Level:

The total cost of all **Municipality** programs increased by \$369 thousand (or 4%).

The General Fund (the primary operating fund) reflected on a current financial resource basis, reports a increase in the accumulated deficit in fund equity by \$516 thousand (or 32%).

USING THIS ANNUAL REPORT

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). The Basic Financial Statements include two kinds of statements that present different views of the **Municipality** as follow:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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 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:

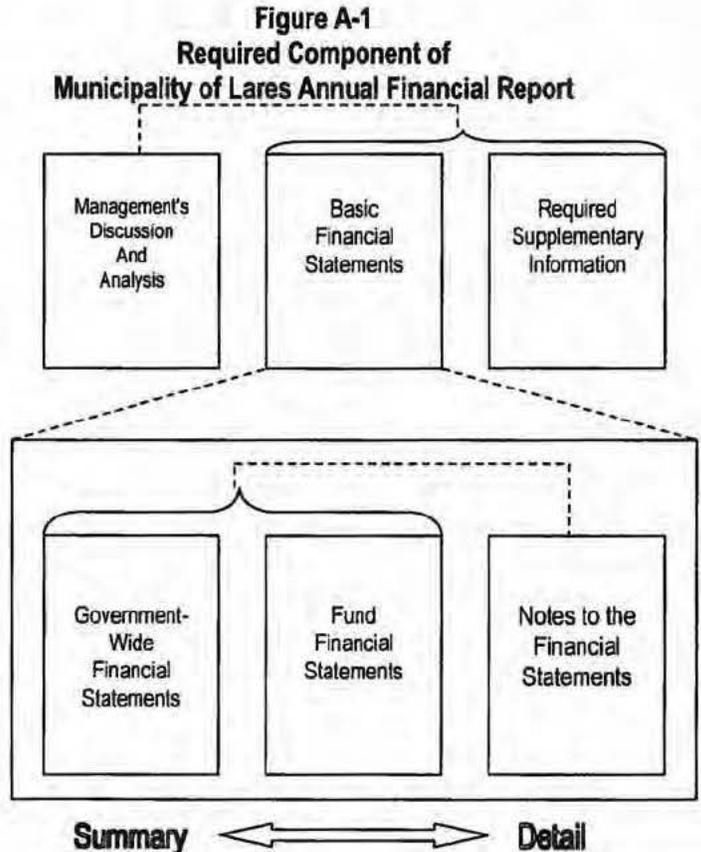
The **Statement of Net Assets** (page 11) presents all the **Municipality's** assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets is an indicator of whether the **Municipality's** financial position is improving or deteriorating.

The **Statement of Activities** (page 12) 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 13 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 (beginning on page 15).



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Governmental Funds – the entire **Municipality's** basic service are reported in the governmental funds, which focus in how money flows into out of those funds and the balances left at year-end that are available for future spending. Consequently, the governmental fund financial statements provide a detailed short-term view of the **Municipality** general information, general operation and the basis service it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the **Municipality's** programs.

These funds are reported using modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. Under this method, revenues are recognized when measurable and available. Expenditures and generally recognized when the related fund liability is incurred. This is the manner in which these funds are normally budgeted.

Since the governmental fund statements (current financial resources) are presented on a different measurement focus and basis of accounting than governmental-wide statements (total economic resources), a reconciliation of the differences are reflected on the page following each statement (see pages 14 and 16). The flow of current financial resources will reflect bond proceeds and interfund transfers as other financing sources as well as capital expenditures and bond principal payments as expenditures. The reconciliation will eliminate these transactions and incorporate the capital assets and long-term obligation (bonds and others) into the Governmental Activities column (in the Government-Wide Statements).

Infrastructure Assets

Historically, a government's largest group of assets [infrastructure – roads, bridges, traffic signals, underground pipes (unless associated with a utility), etc.] have not been reported nor depreciated in governmental financial statements. GASB Statement Number 34 requires that these assets be valued and reported within the Governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the alternative method), which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established condition levels, the government may record all expenditures incurred (except for additions and improvements which extend the asset life) in lieu of depreciation. While the **Municipality** has acquired an asset management system which a) would allow the election to use the alternative methods, and b) will provide valuable management information, the **Municipality** has elected to initially implement the depreciation method, and will monitor and consider, over time, a possible conversion to the alternative method.

Capital Assets Investments

Municipality realized capital assets additions of \$791 thousand and recognized depreciation expenses in the amount of \$355 thousand. Principal investments consist of urban development, streets improvement, building improvement, and equipment acquisitions. Total Investment in Capital Assets, Net of related debt, is \$6.4 million or 73% of total investment (net of depreciation). **Municipality** is in process to capitalized all infrastructures in order to be include on or before the fiscal year 2006-2007.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE GOVERNMENT AS A WHOLE

Summary of Net Assets

The Municipality's net assets decrease by \$680 thousand over the course of this year's operations. The Municipality's net assets include investment in Capital Assets for \$6.4 million and over \$6.4 million restricted for future expenses and capital improvement. The Municipality's net assets at the end of the fiscal year ended on June 30, 2004 were \$8.7 million, as detailed on Table 1. For more detailed information see the Statement of Net Assets on page 11.

Normal Impacts

There are six basic (normal) transactions that will affect the comparability of the Net Assets summary presentation.

- **Net Results of Activities** – This will impact (increase/decrease) current assets and unrestricted net assets.
- **Borrowing for Capital** – This will increase current assets and long-term debts.
- **Spending Borrowed Proceeds on New Capital** – This will reduce current assets and increase capital assets. There is a second impact, an increase in invested in capital assets and an increase in related net debt which will not change the invested in capital assets, net of debt.
- **Spending of Non-borrowed Current Assets on New Capital** – This will (a) reduce current assets and increase capital assets and (b) will reduce unrestricted net assets and increase invested in capital assets, net of debt.
- **Principal Payment on Debt** – This will (a) reduce current assets and reduce long-term and (b) reduce unrestricted net assets and increase invested in capital assets, net of debt.
- **Reduction of Capital Assets through Depreciation** – This will reduce capital assets and invested in capital assets, net of debt.

Current and non-current assets.....	\$ 5,533
Capital assets.....	8,810
Total Assets.....	<u>14,343</u>
Current liabilities.....	1,420
Long-term liabilities.....	4,225
Total Liabilities.....	<u>5,645</u>
Nets Assets:	
Investment in capital assets.....	6,440
Restricted.....	6,425
Unrestricted (Deficit).....	<u>(4,167)</u>
Total Net Assets.....	<u>\$ 8,698</u>

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

Current Year Impacts

The following schedule (as detailed on **Table 2**) presents the revenues and expenses for the current fiscal year.

Normal Impacts

There are five impacts on revenues and expenses as reflected below.

Table 2 Municipality of Lares, Puerto Rico Changes in Net Assets For Fiscal Year Ending June 30, 2004 (in Thousand)	
Revenues:	
Program Revenues:	
Charges for Services	\$ 380
Federal Grants and Contributions	1,547
General Revenues:	
Property Taxes	2,320
Volume of Business Taxes	649
Construction Taxes	668
Intergovernmental	8,009
Other General Revenues	270
Total revenues	<u>13,843</u>
Expenses:	
General Administration	6,735
Public Safety	770
Public Works	1,587
Sanitation	1,050
Culture and Recreation	714
Human Services and Welfare	1,132
Urban Development	2,382
Interest Costs	153
Total expenses	<u>14,523</u>
Changes in net assets	(680)
Net assets – beginning	<u>9,378</u>
Net assets – ending	<u>\$ 8,698</u>

Revenues:

Economic Condition – which can reflect a declining, stable or growing economic environment and has substantial impact on property and volume of business tax revenues as well as public spending habits for building permits, elective user fees and volumes of consumption.

Operating Grants (both recurring and non-recurring) were stable in comparison with prior year.

Intergovernmental Revenues increase primarily for the liquidation of the State Legislature Assignments that produces a positive balance to the **Municipality**.

Expenses:

Introduction of New Programs – within the functional expense categories individual programs may be added or deleted to meet changing community needs.

Increase/Decrease in Authorized Personnel – changes in service demand may cause the **Municipality** to increase/decrease authorized staffing. Staffing costs (salary and related benefits) represent 74% of the **Municipality's** operating cost.

Salary Increases (cost of living, merit and market adjustment) – the ability to attract and retain human and intellectual resources requires the **Municipality** to strive to approach a competitive salary range position in the marketplace. Also, Christmas Bonus for all employees was increase during December 2004.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

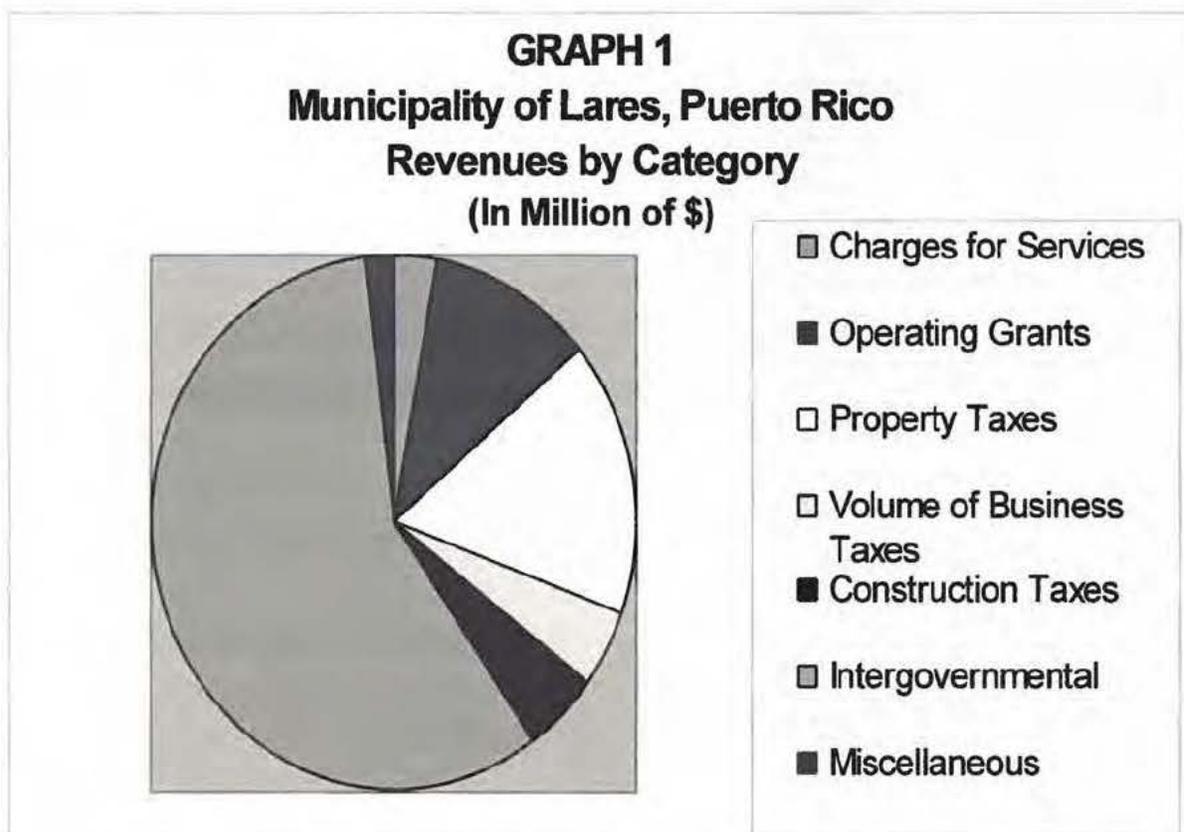
MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Inflation – while overall inflation appears to be reasonably modest, the **Municipality** is a major consumer of certain commodities such as chemicals and supplies, fuels and parts. Some functions may experience unusual commodity specific increases.

Net Assets:

Net Assets reflect an decrease of \$680,444 corresponding to an increase in expenses over revenues. See **Graph 1 and 2** that present revenues by category and expenditures by function.

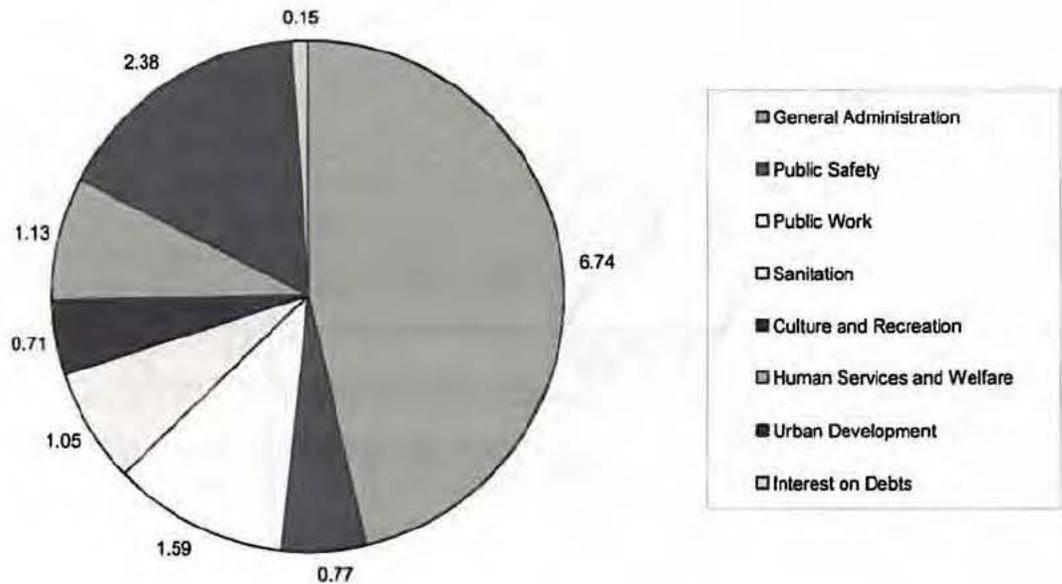


COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

GRAPH 2
Municipality of Lares, Puerto Rico
2004 Expenses By Functions
(In Million of \$)



FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

As the **Municipality's** completed the year, its governmental funds reported fund balances of \$3.2 million. Of this total amount, (\$2.2) million constitute unreserved (deficit) fund balance, which reduced the available fund for appropriation for the general purposes of the programs administer by the **Municipality**.

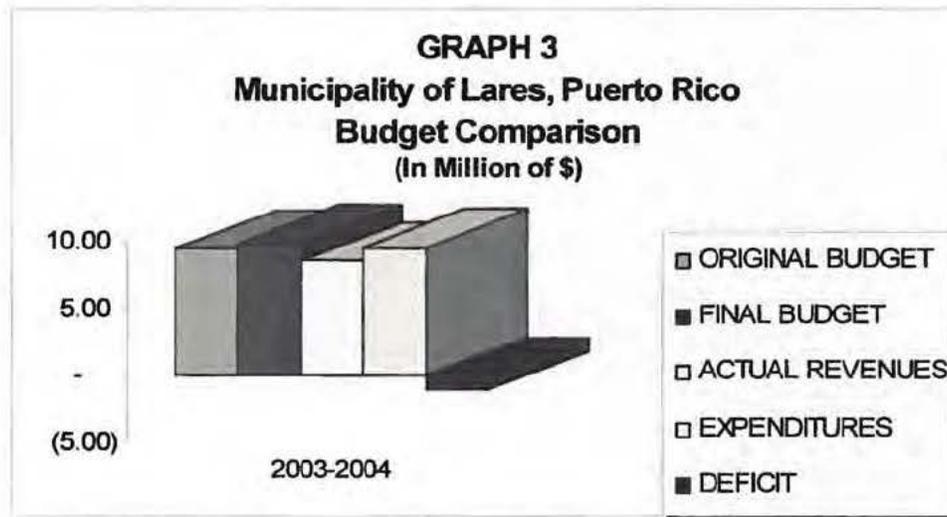
General Fund Budgetary Highlights:

The total budget for the **Municipality** was \$10 million but, actual revenues are \$8.7 million, and actual spending was \$9.7 million. Total expenditures represented 1.12% of total budget availability for the period. Current year budgetary fund balance was negative in the amount of \$1.8 million corresponding to excess of appropriations over revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004



Economic Factors and Next Year's Budgets

For the fiscal year 2003-04, the **Municipality** actual revenues are \$8.7 million, and expenditures exceed for the amount for \$988 thousand. The budget for the year 2004-05 included and estimated additional revenues for the amount of \$200 thousand corresponding to new private projects contemplated for the futures years.

CONTACTING THE MUNICIPALITY'S OFFICE OF FINANCIAL MANAGEMENT

This report is designed to provide a general overview of the **Municipality's** finances and to demonstrate the accountability for the money it receives. If you have any questions about this report or need additional information, contact the **Municipality's** Finance Department at (787) 897-2760.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

STATEMENT OF NET ASSETS

JUNE 30, 2004

	GOVERNMENTAL ACTIVITIES
ASSETS:	
Cash and Investments.....	\$ 4,042,141
Cash with Fiscal Agent.....	199,320
Receivables (net):	
Property Taxes.....	218
Federal Grants.....	1,120,026
Others.....	<u>170,763</u>
Capital Assets (Note 6):	
Land, Improvements, and Construction in Progress.....	2,461,495
Other Capital Assets, [Net of Depreciation].....	<u>6,348,913</u>
Total Capital Assets.....	<u>8,810,408</u>
TOTAL ASSETS	<u>14,342,876</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses.....	946,620
Accrued Interest.....	63,411
Deferred Revenue.....	410,380
Long-Term Liabilities (Note 7):	
Due within One Year.....	1,132,866
Due in More than One Year.....	<u>3,091,877</u>
Total Liabilities	<u>5,645,154</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt.....	6,440,408
Restricted for:	
Capital Projects.....	1,610,434
Debt Service.....	(19,870)
Community Development Projects.....	1,057,875
Other Purposes.....	3,776,554
Unrestricted.....	<u>(4,167,679)</u>
TOTAL NET ASSETS	<u>\$ 8,697,722</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, 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	\$ 1,606,655	\$ -	\$ -	\$ -	(\$ 1,606,655)
General Government	5,128,184	380,485	-	-	(4,747,699)
Public Safety	770,003	-	-	-	(770,003)
Public Works	1,587,590	-	-	-	(1,587,590)
Culture and Recreation	713,773	-	-	-	(713,773)
Sanitation	1,049,959	-	-	-	(1,049,959)
Human Services and Welfare	1,131,989	-	332,171	-	(799,818)
Urban Development	2,381,923	-	1,214,356	-	(1,167,567)
Interest on Long-Term Debt	153,063	-	-	-	(153,063)
Total Governmental Activities	<u>\$14,523,139</u>	<u>\$ 380,485</u>	<u>\$ 1,546,527</u>	<u>\$ -</u>	<u>(12,596,127)</u>
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes					1,928,857
Property Taxes, levied for Debt Service					391,438
Volume of Business Taxes					649,056
Construction Tax					667,710
Intergovernmental					8,009,010
Rent					46,756
Miscellaneous					222,856
Total General Revenues					<u>11,915,683</u>
CHANGE IN NET ASSETS					<u>(680,444)</u>
Net Assets – Beginning of Year					<u>9,378,166</u>
NET ASSETS – ENDING OF YEAR					<u>\$ 8,697,722</u>

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

BALANCE SHEET – GOVERNMENTAL FUNDS

JUNE 30, 2004

	GENERAL	STATE ASSIGNMENTS	SBGP FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS					
Cash and Investments (Note 2).....	\$ -	\$ 3,626,649	\$ 8,158	\$ 959,565	\$ 4,594,372
Cash with Fiscal Agent.....	5,298	-	-	194,022	199,320
Receivables:					
Property Taxes.....	-	-	-	218	218
Federal Grants.....	-	-	1,051,516	68,510	1,120,026
Due from Other Funds.....	582,757	1,167,707	-	70,841	1,821,305
Others.....	5,823	-	-	164,940	170,763
Total Assets.....	<u>\$ 593,878</u>	<u>\$ 4,794,356</u>	<u>\$ 1,059,674</u>	<u>\$ 1,458,096</u>	<u>\$ 7,906,004</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts Payable.....	\$ 908,343	\$ 91,013	\$ 1,491	\$ 267,524	\$ 1,268,371
Accrued Interest.....	-	-	-	63,411	63,411
Due to Governmental Units.....	230,480	-	-	-	230,480
Due to Other Funds.....	1,196,841	2,152	308	622,004	1,821,305
Deferred Revenues:					
Volume of Business Tax.....	408,999	-	-	-	408,999
Federal Grants.....	-	-	950,204	1,381	951,585
Total Liabilities.....	<u>2,744,663</u>	<u>93,165</u>	<u>952,003</u>	<u>954,320</u>	<u>4,744,151</u>
Fund Balances (Deficit):					
Reserve For:					
Encumbrances.....	141,602	-	-	-	141,602
Debt Service.....	-	-	-	(19,870)	(19,870)
Other Purposes.....	5,298	4,701,191	107,671	523,646	5,337,806
Unreserved (Deficit).....	(2,297,685)	-	-	-	(2,297,685)
Total Fund Balances (Deficit).....	<u>(2,150,785)</u>	<u>4,701,191</u>	<u>107,671</u>	<u>503,776</u>	<u>3,161,853</u>
TOTAL LIABILITIES AND FUND BALANCES.....	<u>\$ 593,878</u>	<u>\$ 4,794,356</u>	<u>\$ 1,059,674</u>	<u>\$ 1,458,096</u>	<u>\$ 7,906,004</u>

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

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

JUNE 30, 2004

Total Fund Balances – Governmental Funds (Page 13)..... \$ 3,161,853

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

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

Non Depreciable Capital Assets.....	\$ 2,461,495	
Depreciable Capital Assets	8,803,346	
Infrastructure Assets	274,262	
Accumulated Depreciation	<u>(2,728,695)</u>	
Total Capital Assets		8,810,408

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:

SBGP		950,204
------------	--	---------

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	2,370,000	
Compensated Absences	1,558,819	
Property Tax Advances	<u>295,924</u>	
Total Long-Term Liabilities		<u>(4,224,743)</u>

Total Net Assets of Governmental Activities (Page 11) \$ 8,697,722

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>GENERAL</u>	<u>STATE ASSIGNMENTS</u>	<u>SBGP FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
REVENUES					
Property Taxes	\$ 2,143,494	\$ -	\$ -	\$ 391,438	\$ 2,534,932
Volume of Business Taxes	649,056	-	-	-	649,056
Federal Assurances	-	-	1,159,876	332,171	1,492,047
Intergovernmental	5,077,779	1,529,122	-	1,402,109	8,009,010
Licenses and Permits	667,710	-	-	-	667,710
Rent	46,756	-	-	-	46,756
Miscellaneous	569,744	-	-	33,597	603,341
Total Revenues	9,154,539	1,529,122	1,159,876	2,159,315	14,002,852
EXPENDITURES					
Current:					
Mayor and Municipal Legislature	576,954	-	-	-	576,954
General Government	3,741,399	1,126,992	-	371,097	5,239,488
Public Safety	762,247	-	-	-	762,247
Public Works	1,783,181	-	-	-	1,783,181
Culture and Recreation	698,680	-	-	-	698,680
Health and Sanitation	1,099,462	-	-	-	1,099,462
Human Services and Welfare	711,811	253,764	-	277,329	1,242,904
Urban Development	28,326	-	1,052,205	1,235,098	2,315,629
Capital Outlay	22,914	788,030	-	162,951	973,895
Debt Service:					
Principal	-	-	-	283,000	283,000
Interest and Other Charges	-	-	-	153,063	153,063
Total Expenditures	9,424,974	2,168,786	1,052,205	2,482,538	15,128,503
OTHER FINANCING SOURCES (USES)					
Transfers - In	-	-	-	245,844	245,844
Transfers - Out	(245,844)	-	-	-	(245,844)
Total Other Financing Sources and Uses	(245,844)	-	-	245,844	-
Net Change in Fund Balances	(516,279)	(639,664)	107,671	(77,379)	(1,125,651)
Fund Balance (Deficit) - Beginning, as Restated (Note 14)	(1,634,506)	5,340,855	-	581,155	4,287,504
FUND BALANCES - ENDING	(\$ 2,150,785)	\$ 4,701,191	\$ 107,671	\$ 503,776	\$ 3,161,853

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, 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 15) (\$ 1,125,651)

Amounts reported for Governmental Activities in the Statement of Activities (Page 12)
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	\$ 794,401	
Depreciation Expense	<u>(355,502)</u>	
Excess of Capital Outlay over Depreciation Expense		438,899

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

SBGP	54,480	
Municipal Revenue Collection Center (Property Taxes)	<u>(214,637)</u>	
Total Adjustment to Revenues		(160,157)

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. 283,000

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..... (116,535)

Change in Net Assets of Governmental Activities (Page 12) (\$ 680,444)

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Lares, Puerto Rico (Municipality)** was founded in the year 1827, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomous Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

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

The accounting policies of the **Municipality** conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant 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, 2003. They require new information and restructure much of the information that governments have presented in the past.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

The accompanying basic financial statements present the financial position and the results of operations of the **Municipality** and its various funds and fund types, and the cash flows of the proprietary funds. 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.

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**.

B. Measurement Focus and Basis of Accounting

The relative importance of each criterion 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.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 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 some grants, funds 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

C. Financial Statement Presentation, (continuation)

Government-wide Financial Statements

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

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

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

- **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These results when constraints are placed on net assets use, which can be either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consists 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Governmental Fund Financial Statements

The fund financial statements (the **Balance Sheet** and the **Statement of Revenues, Expenditures, and Changes in Fund Balances**) 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 a different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and a 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:

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.

State Assignment Fund – This is the fund used to account for all the transactions of the State Assignment by Legislature Resolutions. The primary objectives of these assignments is the development of projects on communities, not-for-profit organizations, purchase of equipment and indirect assignment to persons of low and moderate income.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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

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

D. Budgetary Data

The **Municipality** annually adopts the Budget Resolution for all operating funds of the **Municipality** except for certain restricted accounts of Proprietary Funds and 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 15 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 recommendations before the deadline established by the Law.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

D. Budgetary Data (continuation)

4. Prior to June 13, the annual budget is legally enacted through the approval 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.

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 are 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 9).
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 Finance Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily a year. Accordingly, the presentation of an annual comparison of budget for such programs was deemed not practical.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

E. Cash, Cash Equivalent and Investment

The Finance Director 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.

This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, an agency which acts as the insurer and payer of the **Municipality's** bonds and notes issued in accordance with law.

F. Receivable

Receivables are stated net 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 purchase office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as an 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.

CAPITAL ASSETS	YEARS
Buildings and Improvements	50
Infrastructure	60
Heavy Equipment	10
Furniture and Fixtures	5
Equipment and Vehicles	5-10

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives: (See Table 1)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 amount 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 amount allowed. The **Municipality** accrues a liability for compensated absences which meet the following criteria:

1. The **Municipality's** obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
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 the **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).

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2004 (Table 2).

Table 2 BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2004	CURRENT PORTION	LONG-TERM PORTION
<u>\$1,442,284</u>	<u>\$ 116,535</u>	<u>\$ -</u>	<u>\$1,558,819</u>	<u>\$ 833,866</u>	<u>\$ 724,953</u>

J. Insurance

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

Residual Equity Transfers – Nonrecurring or no routine transfers of equity between funds. During the Fiscal Year 2003-2004 no transfers of this kind were made.

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 Liabilities 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 2 CASH AND CASH EQUIVALENTS

The **Municipality's** cash and cash equivalents 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, which are unsecured and uncollateralized.

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** did not invest its funds in short-term certificates of deposit.

NOTE 3 OTHER RECEIVABLES

As of June 30, 2004, the amount of \$548,580 corresponds to an agreement with the quasi public Corporation, PR Electric Power Authority, for the revision of the "In lieu of tax" payments from prior years, \$155,665 for final liquidation of this Corporation, \$462,933 from revision of Intergovernmental Revenue from Municipal Revenue Collection Center and \$20,213 from others.

NOTE 4 INTERFUND TRANSFERS AND BALANCES

A. INTERFUND TRANSFERS

Transfers are indicative of funding for capital projects (See Table 3).

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			TABLE 3
SOURCES	TRANSFER TO	AMOUNT	PURPOSE
General Fund	Other Fund	<u>\$245,844</u>	Specific Project Funding

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2004 are summarized as follows (See Table 4):

INTERFUND RECEIVABLE	INTERFUND PAYABLE	TABLE 4 AMOUNT
General Fund	Other Fund	\$ 580,297
General Fund	State Assignment Fund	2,152
State Assignment Fund	General Fund	1,126,000
Other Fund	General Fund	70,841
State Assignment Fund	Other Funds	41,707
General Fund	SBGP	<u>308</u>
TOTAL		<u>\$1,821,305</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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: (See Table 5)

TABLE 5	AMOUNT
Water Company.....	\$ 17,545
Retirement System Administration	72,123
General Service Administration	128,835
Other	<u>11,977</u>
Total Due to Governmental Units	<u>\$230,480</u>

NOTE 6 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2004 was as follows (See Table 6)

TABLE 6	BALANCE JULY 1, 2003	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2004
Non-Depreciable Capital Assets:				
Land	\$ 2,093,639	\$ 56,495	\$ -	\$ 2,150,134
Construction in Progress	-	311,361	-	311,361
Total Non-Depreciable Capital Assets	<u>2,093,639</u>	<u>367,856</u>	-	<u>2,461,495</u>
Depreciable Capital Assets:				
Buildings and Building Improvement	6,062,566	77,432	-	6,139,998
Infrastructure	-	274,262	-	274,262
Equipment and Vehicles	1,827,194	71,403	-	1,898,597
Furniture and Fixtures	92,975	3,448	-	96,423
Heavy Equipment	<u>668,328</u>	-	-	<u>668,328</u>
Total Depreciable Capital Assets	<u>8,651,063</u>	<u>426,545</u>	-	<u>9,077,608</u>
Less Accumulated Depreciation:				
Buildings and Building Improvement	(532,515)	(101,290)	-	(633,805)
Infrastructure	-	(208)	-	(208)
Equipment and Vehicles	(1,503,977)	(181,374)	-	(1,685,351)
Furniture and Fixtures	(55,376)	(10,077)	-	(65,453)
Heavy Equipment	<u>(281,325)</u>	<u>(62,553)</u>	-	<u>(343,878)</u>
Total Accumulated Depreciation	<u>(2,373,193)</u>	<u>(355,502)</u>	-	<u>(2,728,695)</u>
Total Depreciable Capital Assets (Net)	<u>6,277,870</u>	<u>71,043</u>	-	<u>6,348,903</u>
CAPITAL ASSETS, NET	<u>\$ 8,371,509</u>	<u>\$ 438,899</u>	<u>\$ -</u>	<u>\$ 8,810,408</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 6 CAPITAL ASSETS (continuation)

Depreciation expenses were charged to governmental functions/programs as follows: (See Table 7)

TABLE 7	AMOUNT
General Government.....	\$ 183,654
Mayor and Legislature.....	4,221
Public Safety.....	7,759
Public Works and Transportation	81,401
Culture.....	15,093
Sanitation.....	629
Health and Welfare.....	4,935
Urban Development.....	57,810
Total Depreciation Expenses.....	<u>\$ 355,502</u>

NOTE 7 GENERAL LONG-TERM DEBTS

A. GENERAL OBLIGATIONS BONDS

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 8).

General obligations bonds as of June 30, 2004, are comprised of the following individual issues:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 7 GENERAL LONG-TERM DEBTS (continuation)

A. GENERAL OBLIGATIONS BONDS (continuation)

<u>DESCRIPTION</u>	<u>AMOUNT</u>
General Obligations Bonds:	
\$750,000, Series 2002, for purchase of land, payable in annual installments ranging from \$5,000 to \$65,000, excluding interests at 8%, through July 1, 2026.....	\$ 725,000
\$300,000, Series 1982, for improvement to the portable water system, payable in annual installments ranging from \$4,000 to \$20,000, excluding interests at 5%, through January 1, 2007	57,000
\$1,045,000, Series 1994, for construction purposes, payable in annual installments ranging from \$10,000 to \$90,000, excluding variable interests from 6% to 8%, through July 1, 2022	940,000
\$1,020,000, Series 1992, for construction purposes, payable in annual installments ranging from \$30,000 to \$115,000, excluding interests at 7.5%, through July 1, 2007	315,000
\$237,000, Series 1998, for purchase of equipment, payable in annual installments ranging from \$30,000 to \$38,000, excluding interests at 4.50%, through January 1, 2005 (Water & Waste Disposal Loans & Grants) ...	38,000
\$126,000, Series 1999, for purchase of equipment, payable in annual installments ranging from \$40,000 to \$60,000, excluding interests at 4.75%, through January 1, 2005 (Water & Waste Disposal Loans & Grants) ...	21,000
\$435,000, Series 2000, for construction purposes, payable in annual installments ranging from \$53,000 to \$72,000, excluding interests at 5%, through January 1, 2007 (Community Facilities Loans Program).....	205,000
\$148,000, Series 2000, for construction purposes, payable in annual installments ranging from \$19,000 to \$24,000, excluding interests at 4.375%, through January 1, 2007 (Water & Waste Disposal Loans & Grants) .	<u>69,000</u>
Total General Obligations Bonds	<u>\$2,370,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 7 GENERAL LONG-TERM DEBTS (continuation)

A. GENERAL OBLIGATIONS BONDS (continuation)

The annual requirements to amortize the general obligations outstanding as of June 30, 2004 are as follows (See Table 8):

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TABLE 8 TOTAL PAYMENT
2005	\$ 299,000	\$ 137,442	\$ 436,442
2006	255,000	120,892	375,892
2007	276,000	105,898	381,898
2008	45,000	89,400	134,400
2009	55,000	87,111	142,111
2010-2014	325,000	388,788	713,788
2015-2019	495,000	277,943	772,943
2020-2024	495,000	111,064	606,064
2025-2029	<u>125,000</u>	<u>10,640</u>	<u>135,640</u>
TOTAL	<u>\$2,370,000</u>	<u>\$1,329,178</u>	<u>\$3,699,178</u>

B. OTHER LONG-TERM DEBTS

Following are the Other Long-Term Debts (See Table 9):

TABLE 9 DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2004
Property Taxes – MRCC ...	\$ 894,062	\$ -	\$ 619,539	\$ 274,523
Property Taxes – Treasury.	24,047	-	2,646	21,401
State Health Insurance.....	109,250	-	109,250	-
Solid Waste Disposal.....	392,126	-	392,126	-
Compensated Absences....	<u>1,442,284</u>	<u>116,535</u>	-	<u>1,558,819</u>
TOTAL.....	<u>\$2,861,769</u>	<u>\$ 116,535</u>	<u>\$1,123,561</u>	<u>\$1,854,743</u>

C. CHANGES IN GENERAL LONG-TERM DEBTS

The following is a summary of changes in long-term debts for the year ended June 30, 2004 (See Table 10):

TABLE 10 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	\$2,653,000	\$ -	\$ 283,000	\$2,370,000	\$ 299,000	\$2,071,000
Others Debts	<u>2,861,769</u>	<u>116,535</u>	<u>1,123,561</u>	<u>1,854,743</u>	<u>833,866</u>	<u>1,020,877</u>
TOTAL	<u>\$5,514,769</u>	<u>\$ 116,535</u>	<u>\$1,406,561</u>	<u>\$4,224,743</u>	<u>\$1,132,866</u>	<u>\$3,091,877</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 8 DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the **Municipality** (See Note 9).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the **Municipality** (See Note 7). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

NOTE 9 PROPERTY TAXES

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

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

The tax rate per annum is 7.83% for real property and 5.83% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 6.80% and 4.80%, respectively, belongs to the **Municipality**. From the portion belonging to the **Municipality**, 5.55% and 3.55%, 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 not 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 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 9 PROPERTY TAXES (continuation)

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 Municipal 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. 0.30% for all other organizations.

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

NOTE 11 INTERGOVERNMENTAL REVENUES

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 12 EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its instrumentality (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 instrumentality 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 Instrumentality, Assistants of 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 \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. The **Municipality** contributes to the system 9.275% of the participating employee's salaries.

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

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation for 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:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 12 EMPLOYEE'S RETIREMENT PLAN (continuation)

- 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 (See **Table 11**)

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS	TABLE 11
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.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2004 was approximately **\$348,598**. 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 12 EMPLOYEE'S RETIREMENT PLAN (continuation)

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

A. CLAIMS AND JUDGMENTS

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

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

B. FEDERAL GRANTS

In the normal course of operations, the **Municipality** receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

NOTE 14 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS

During fiscal year 2003-2004, the **Municipality** implemented several new accounting standards and an interpretation issued by GASB.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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

GASBS No. 34 as amended by GASBS No. 37, 40 and 41 establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statement balances were required.

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

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

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

Also, restatements were presented for prior period adjustment of Special Revenue Funds of the Audited Financial Statements as of June 30, 2003. Table 12 reconciles the June 30, 2003 Fund Balance, as previously reported to Beginning Fund Balance as restated, July 1, 2003.

FUND BALANCE RESTATED	Table 12
	OTHER GOVERNMENTAL FUND
Fund Balances (Deficit), as Previously Reported, June 30, 2003	\$604,228
Adjustments to revenues in accordance with GAAP	<u>(23,073)</u>
Beginning Fund Balances, as Restated, July 1, 2003	<u>\$581,155</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 pronouncements are:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 15 FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENT (continuation)

GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. Statement 43 establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, with modifications to reflect differences between pension plans and OPEB plans. The implementation of this Statement is required in financial statements for periods beginning after December 15, 2007. Early implementation of this Statement is encouraged.

GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*. Statement 44 enhances and updates the statistical section that accompanies a state or local government's basic financial statements to reflect the significant changes that have taken place in government finance, including the more comprehensive government-wide financial information required by GASB Statement 34. The statistical section is a required part of a comprehensive annual financial report (CAFR), although governments are not required to prepare a statistical section if they do not present their basic financial statements within a CAFR. The provisions of this Statement are effective for statistical sections prepared for periods beginning after June 15, 2005.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. The implementation of this Statement is required in financial statements for periods beginning after December 15, 2007. Early implementation of this Statement is encouraged.

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*, an amendment of GASB Statement No. 34. The purpose of Statement 46 is to help governments determine when net assets have been restricted to a particular use by the passage of enabling legislation and to specify how those net assets should be reported in financial statements when there are changes in the circumstances surrounding such legislation. Statement 46 is effective for periods beginning after June 15, 2005.

END OF NOTES

MUNICIPALITY OF LARES, PUERTO RICO

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2004

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, 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	(\$ 847,934)	(\$ 847,934)	(\$ 847,934)	\$ -
Resources (Inflows):				
Property Taxes	1,344,488	1,724,664	1,724,665	1
Volume of Business Taxes	740,000	740,000	649,056	(90,944)
Intergovernmental Revenues	4,967,201	4,967,201	5,029,872	62,671
License and Permits	1,008,000	1,008,000	667,710	(340,290)
Rent	130,000	130,000	46,756	(83,244)
Miscellaneous	<u>1,410,311</u>	<u>1,410,311</u>	<u>569,744</u>	<u>(840,567)</u>
Total Resources (Inflows)	<u>9,600,000</u>	<u>9,980,176</u>	<u>8,687,803</u>	<u>(1,292,373)</u>
Amounts Available for Appropriation	<u>8,752,066</u>	<u>9,132,242</u>	<u>7,839,869</u>	<u>(1,292,373)</u>
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	508,563	605,440	580,780	24,660
General Government	3,791,508	4,022,896	3,722,523	300,373
Public Safety	898,466	763,447	762,761	686
Public Works	1,797,362	1,822,419	1,810,007	12,412
Sanitation	987,093	1,060,584	1,099,462	(38,878)
Culture and Recreation	707,008	702,896	693,211	9,685
Human Services and Welfare	751,500	715,355	709,555	5,800
Urban Development	20,000	34,922	28,326	6,596
Capital Outlays	48,500	26,462	22,914	3,548
Transfer to Other Funds	<u>90,000</u>	<u>225,755</u>	<u>245,844</u>	<u>(20,089)</u>
Total Charges to Appropriations	<u>9,600,000</u>	<u>9,980,176</u>	<u>9,675,383</u>	<u>304,793</u>
BUDGETARY FUND BALANCE, JUNE 30, 2004	(\$ 847,934)	(\$ 847,934)	(\$ 1,835,514)	(\$ 987,580)

See accompanying Notes to Required Supplementary Information.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTE 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 39).....	\$ 7,839,869
Difference – Budget to GAAP:	
The Fund Balance (Deficit) at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes.	847,934
Prior-Year Revenue is not inflows of budgetary resources but are <i>revenues</i> for financial reporting purposes.....	<u>466,736</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15)	<u>\$ 9,154,539</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 39).....	\$ 9,675,383
Difference – Budget to GAAP:	
Prior-Year Expenditures are not outflows of budgetary resources but are <i>expenditures</i> for financial reporting purposes.....	103,026
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes.	(107,591)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.....	<u>(245,844)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15)	<u>\$ 9,424,974</u>
NOTE B Explanation of Differences between Budgetary Fund Balance and GAAP Fund Balance	
Budgetary Fund Balance, June 30, 2004 (See Page 39)	(\$ 1,835,514)
Timing Differences:	
Net Change in Encumbrances	46,951
Non-budgetary Items	<u>(509,122)</u>
Unreserved Fund Balance (Deficit) (See Page 13).....	<u>(\$ 2,297,685)</u>

END OF THIS SECTION

MUNICIPALITY OF LARES, PUERTO RICO

SINGLE AUDIT SECTION

YEAR ENDED JUNE 30, 2004

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

FEDERAL GRANTOR / PASS-THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Section 8 Housing Choice Vouchers.....	14.871		\$ 276,822
Indirect Programs:			
Pass-Through State – Office of the Commissioner of Municipal Affairs:			
State Block Grant Program (SBGP).....	14.228	94-FD-37 95-FD-37 01-FD-37 01-FC-37 02-FC-37 02-AB-37	<u>1,052,205</u>
Total U.S. Department of Housing and Urban Development			<u>1,329,027</u>
U.S. Department of Justice:			
Pass-Through Puerto Rico Department of Justice:			
Local Law Enforcement Block Grant Program	16.592	N/A/V	<u>89,240</u>
U.S. Department of Transportation:			
Pass-Through Safety Transit Commission:			
State and Community Highway Safety.....	20.600	N/A/V	<u>54,583</u>
U.S. Federal Emergency Management Agency:			
Pass-Through Office of the Governor Authorized Representative (GAR):			
Public Assistant Grants	83.544	FEMA1247DR-PR-081	<u>150,778</u>
Total U.S. Federal Emergency Management Agency.....			<u>150,778</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS.....			<u>\$1,623,628</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the **Municipality of Lares, Puerto Rico**. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The **Municipality** reporting entity is defined in Note (1) (A) to the general-purpose financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed through other government agencies are included on the Schedule.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

NOTE 3 FEDERAL CFDA NUMBER

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

NOTE 4 PASS THROUGH GRANTOR'S NUMBER

State or local government redistribution of federal awards to the **Municipality**, treated as if they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass through entity and identifying number assigned by the pass through entity for federal awards received as a subrecipient. Numbers identified as N/AV are not available.

NOTE 5 RELATIONSHIP TO GENERAL-PURPOSE COMBINED FINANCIAL STATEMENTS

Federal financial assistance expenditures are reported in the **Municipality's** Combined Statement of Revenues, Expenditures and Change in Fund Balance – All Governmental Fund Types as follows:

DESCRIPTION	SPECIAL REVENUE	CAPITAL PROJECT	TOTAL
Federal Programs Expenditures	\$1,298,316	\$ 325,312	\$1,623,628
State & Municipal Expenditures	<u>2,582,683</u>	<u>1,497,218</u>	<u>4,079,901</u>
TOTAL EXPENDITURES.....	<u>\$3,880,999</u>	<u>\$ 1,822,530</u>	<u>\$5,703,529</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continuation)

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 6 LOANS OUTSTANDING

The **Municipality of Lares, Puerto Rico** had the following outstanding balances at June 30, 2004 for the Community Facilities Loan Program, and Water and Waste Disposal Loans and Grants Program. For these loans the grantor does not impose continuing compliance requirements, as described on the OMB Circular A-133. The amounts presented in the Schedule of Expenditures of Federal Awards, represent expenditures according to modified accrual basis of accounting (see Note 1). The loans outstanding balances were included in the **Municipality's** General Long Term-Debt Account Group (see Note 7 of the Notes to General-Purpose Financial Statements).

PROGRAM TITLE	FEDERAL CFDA NUMBER	AMOUNT OUTSTANDING
Community Facilities Loan Program.....	10.660	\$205,000
Water and Waste Disposal Loans and Grants	10.770	38,000
Water and Waste Disposal Loans and Grants	10.770	21,000
Water and Waste Disposal Loans and Grants	10.770	69,000

NOTE 7 MAJOR PROGRAMS

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

END OF NOTES



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ROMAN TORO & CO., CSP
Certified Public Accountants and Business Consultants

Members of:

American Institute of Certified Public Accountants
Puerto Rico Society of Certified Public Accountants

Partners:

Juan E. Román Toro, MBA, CPA
José D. Román Toro, CPA

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

Honorable Mayor and Members of the
Municipal Assembly
Municipality of Lares, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Lares, Puerto Rico**, as of and for the year ended June 30, 2004, which collectively comprise Municipality of Lares' basic financial statements and have issued our report thereon dated March 21, 2005. 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 Municipality of Lares, Puerto Rico's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect 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 2004 – 1,2,3,4 and 5.

Internal Control Over Financial Reporting

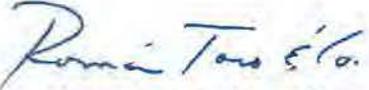
In planning and performing our audit, we considered Municipality of Lares' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we considered 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 financial reporting that, in our judgement, could adversely affect the Municipality of Lares' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2004 – 1,2,3,4 and 5.

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

(CONTINUED)

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 caused by errors or fraud in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. However, we believe all the reportable conditions described above are material weaknesses.

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


ROMAN TORO & CO., CSP
LICENSE #35 – IN FORCE

Yauco, Puerto Rico
March 21, 2005

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Certified Public Accountants and Business Consultants

Members of:

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Puerto Rico Society of Certified Public Accountants*

Partners:

*Juan E. Román Toro, MBA, CPA
José D. Román Toro, CPA*

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

Honorable Mayor and Members of the
Municipal Assembly
Municipality of Lares, Puerto Rico

Compliance

We have audited the compliance of **Municipality of Lares, Puerto Rico** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. Municipality of Lares' 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 Municipality of Lares' management. Our responsibility is to express an opinion on Municipality of Lares' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality of Lares' 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 of Municipality of Lares' compliance with those requirements.

In our opinion, Municipality of Lares, Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-6.

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

(CONTINUED)

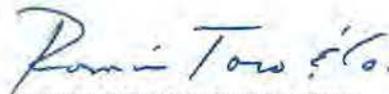
Internal Control Over Compliance

The management of Municipality of Lares, Puerto Rico, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Lares' 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 considered 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 judgement, could adversely affect the regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as item 2004-6.

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 caused by errors or fraud 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 a 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 conditions described above is a material weakness.

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


ROMAN TORO & CO., CSP
LICENSE #35 – IN FORCE

Yauco, Puerto Rico
March 21, 2005

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the original of this report

**MUNICIPALITY OF LARES, PUERTO RICO
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 FOR THE YEAR ENDED JUNE 30, 2004**

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditor's 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 auditor's report issued on compliance for Major Programs: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

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

Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
14.228	State Block Grant Program US Department and Urban Development Pass-through State Office of Commissioner of Municipal Affairs

Dollar threshold used to distinguish between Type A and Type B Programs: \$300,000

Auditee qualified as low-risk auditee? Yes No

**MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2004**

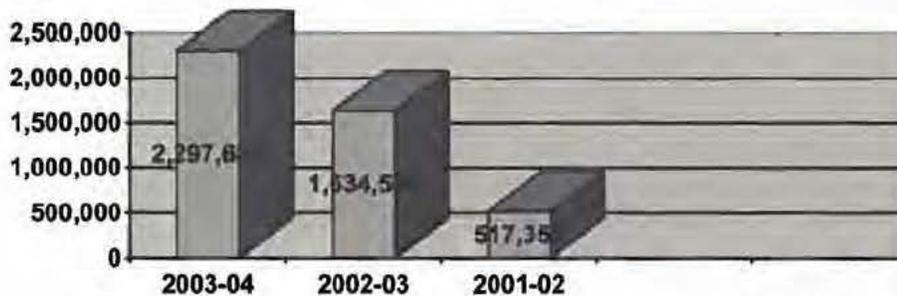
SECTION II – FINANCIAL STATEMENT FINDINGS

2004-1: General fund deficit

Condition

As of June 30, 2004 the Municipality closed with an accumulated deficit of \$2,297,685. This is the third consecutive year that the Municipality closed its operations reporting a deficit. The current year deficit represents an increase of 41% when compared to prior year operations, and a 344% increase since the deficit was first reported in the fiscal year ended in June 30, 2002.

Acumulated Deficit



Cause

The deficit is caused by the overestimation of budgeted revenues and by the incurrence of obligations without the proper consideration of current and future available resources. The mayor and the finance director did not follow adequate budgeting procedures.

Criteria

Article 7.011(a) of Autonomous Municipal Act (Law 81 of August 30, 1991), as amended, establishes that municipalities with deficits at their closing dates must provide for sufficient resources during the next fiscal year period in order to cover such deficit.

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that special care must be provided for the estimation of future revenues in order to avoid budget appropriations in excess of available resources.

Recommendation

The continuing deficit reported by the Municipality of Lares may harm the basic governmental services provided to its citizens. We strongly recommend that the necessary measures are taken in order to stop this trend. The Municipality must work on increasing actual revenues and/or substantially reducing expenditures.

Management response

Pending Corrective Action

**MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2004**

2004-2: Estimated revenue shortfall

Condition

As of June 30, 2004, the Municipality did not meet certain projected revenues by significant amounts, causing an increase in its General Fund deficit (see Finding 2004-1). The following deficiencies were noted based on our comparison of budgeted revenues versus final operating results:

- For Licenses and Permits revenues, the Municipality failed to meet its expectations by \$340,290, a 33.76% budget shortfall.
- For Rent revenues, the Municipality failed to meet its expectations by \$83,244, a 64.03% budget shortfall.
- For Miscellaneous revenues, the Municipality failed to meet its expectations by \$840,567, a 59.60% budget shortfall.

Criteria

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that special care must be provided for the estimation of future revenues in order to avoid budget appropriations in excess of available resources.

Cause

The mayor and the finance director did not follow adequate budgeting procedures for establishing reasonable estimates.

Recommendation

The actual revenues for fiscal year ended in June 30, 2004 were \$8,687,869. However, state law requires Municipalities to set aside a portion to eliminate prior year deficit which amounted to \$847,934 at the beginning of the fiscal year (See Budgetary Comparison Schedule, page 39 of the financial statements). After this adjustment, actual available resources for the fiscal year were \$7,839,869. When considering the current year general fund deficit of \$2,297,685 in the 2004-05 fiscal year's approved budget, the estimated available resources for appropriations will be approximately \$6,400,000, which would represent only 64% of the total actual revenues generated in 2003-2004. If 2004-05 expenditures remain relatively the same as the current years, we estimate a general fund deficit of approximately \$5,600,000.

Management response

Pending Corrective Action

**MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2004**

2004-3: Unauthorized transfer of state special funds

Condition

The Municipality realized several unauthorized transfers from its special revenue fund accounts to its General Fund during the fiscal year ended in June 30, 2004. These unauthorized transfers are detailed as follows:

<u>Joint Resolution</u>	<u>Project Name</u>	<u>Transfer Amount</u>	<u>Transfer Date</u>
RC04303668	Plaza del Mercado	\$ 500,000.00	9/16/03
RC04303668	Plaza del Mercado	300,000.00	12/9/03
RC04303668	Plaza del Mercado	150,000.00	1/27/04
RC13193580	Centro Cultural 23 de septiembre	51,000.00	6/2/04
RC13193926	Centro Comunitario de Pezuela	25,000.00	6/2/04
RC04303873	Pisicina y Gimnasio	<u>100,000.00</u>	6/4/04
		<u>\$1,126,000.00</u>	

Criteria

Article 8 of the Resource Allocation for the Realization of Permanent Works, Acquisition of Equipment, Purchase of Materials and Other Social Interest Activities Act (Law 179 of August 16, 2002) requires municipalities to utilize funds from state grants only for the intended purpose established by the Joint Resolution of the Puerto Rico Legislature and may not expend these in any activity not specifically and categorically addressed in the legislative grant. The use of funds from state grants in activities other than those mentioned in the Joint Resolution requires the prior approval of the Puerto Rico Legislature.

Cause

The bank transfers were authorized by the Finance Director through letters to bank. These transfers were made to compensate cash deficiency the municipality was facing to pay current operating obligations. The Mayor and the Finance Director performed these transfers in violation of state law.

Recommendation

We recommend the Municipality refer this case to the appropriate regulatory bodies.

Management response

Pending Corrective Action

**MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2004**

2004-4: Unrecorded expenditures

Condition

As part of our search for unrecorded liabilities, we found that certain expenditures totaling \$12,318.42 did not comply with state laws and regulations as of June 30, 2004. The expenditures identified as non-compliant are detailed below:

<u>Program</u>	<u>Description</u>	<u>Invoice Number</u>	<u>Invoice Amount</u>	<u>Invoice Date</u>
General Services	Lubricants and Gas	04504877	\$ 7,039.41	5/18/04
General Services	Lubricants and Gas	04504487	5,279.01	6/22/04
			<u>\$12,318.42</u>	

The following deficiencies were noted in these items:

- The invoices were not recorded in the accounting records as of June 30, 2004 and, therefore, the related reports did not include these incurred costs.
- No budgetary item was available to charge these costs and no funds were available for the disbursing of costs.

The proper accounting of these costs have reflected a more accurate increase in the Municipality's deficit at the fiscal year end date due to the previously unbudgeted costs.

Criteria

The situation presented above represents a deviation from generally accepted accounting principles for governmental entities. All governmental entities must record and obligate any invoices in good standing for goods received and services rendered during the course of normal operations.

Cause

The deviations identified occur due to insufficient monitoring controls over the recording and processing of the Municipality's obligations. The Finance Department did not perform adequate cut-off procedures to assure all payables are properly recorded at the closing date.

Recommendation

The Municipality should improve its internal controls in normal accounting procedures in order to reduce the likelihood of future unrecorded obligations at the closing date.

Management response

Pending Corrective Action

**MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2004**

2004-5: Insufficient supporting documentation for disbursements

Condition

The Municipality could not provide sufficient supporting documentation for several disbursements made during the fiscal year. The following payments were found to contain exceptions:

<u>Check Number</u>	<u>Check Date</u>	<u>Check Amount</u>
32406	12/12/03	\$51,333.32
32423	12/16/03	<u>14,201.02</u>
		<u>\$65,534.34</u>

Criteria

Section 12 of the Revised Regulations over Basic Standards for Municipalities of Puerto Rico states that canceled payments and any other document which justifies the disbursement should be appropriately filed and stored to provide access to the Controller of Puerto Rico for audit purposes. Additionally, Section 13 of the Regulations requires the Municipality to disburse funds for vendors only if a signed invoice was submitted, a contract or similar document exists and if the services were rendered and/or goods received.

Cause

This situation occurs because of the lack of proper monitoring controls over the maintenance of accounting documentation.

Recommendation

The Municipality should improve its documenting procedures and should accompany each disbursement with appropriate supporting documentation.

Management response

Pending Corrective Action

**MUNICIPALITY OF LARES, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2004**

SECTION III – FINANCIAL AWARD FINDINGS AND QUESTIONED COSTS

2004-6: Construction contracts did not contain required clauses

Federal Program

STATE BLOCK GRANT PROGRAM (CFDA 14.228)
US DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
PASS-THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS

Requirement

Compliance and Internal Control

Noncompliance

Procurement and suspension and debarment

Condition

The model for construction contracts over \$10,000 used by the Municipality did not contain the detailed clauses for compliance with the provisions for termination by grantee for default; contractual legal remedies when contractor violates the terms. For contracts over \$100,000, federal regulations require provisions for Clear Air and Clear Water Act, Energy Policy and Conservation Act and Certifications for Suspension and Debarment. (This is a prior year finding)

Criteria

Code of Federal Regulations, Subpart C, 24 CFR Section 85.36 (i) (1-13), and 44 CFR Section 13.36 (l) (1-13) states that sub grantee's contracts must contain the provisions in paragraph (i) of these sections. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by Office of Procurement Policy.

Cause

Federal Programs and Finance Departments did not maintain appropriate procurement standards procedures in order to assure that contractors comply with federal requirements.

Recommendation

We recommend that the Municipality update its contract model according with federal requirements.

Questioned costs

None

Management response

Pending Corrective Action

**MUNICIPALITY OF LARES, PUERTO RICO
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2004**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Cost	Comments
(1) Audit Findings that have been fully corrected:					
2003	03-III-01	Allowable cost / cost principles – Lack of receiving reports in 15 vouchers	14.228	None	System and procedures were corrected.
2003	03-III-02	Equipment and Real Property Management – Lack of an adequate property register	14.228	None	System and procedures were corrected.
(2) Audit Findings not corrected or partially corrected:					
2003	03-III-03	Procurement and Suspension and Debarment – Construction contract did not contain certain required clause	14.228	None	Finding still prevails in 2004 audit. The administration should adopt a contract model that comply with the federal regulation
(3) Corrective action taken is significantly different from corrective action previously reported:					
NONE					
(4) Audit findings is no longer valid:					
NONE					

END OF SCHEDULE

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