

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

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

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA**

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

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

TABLE OF CONTENTS

	<u>Pages</u>
PART I - FINANCIAL SECTION	
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-9
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11
Fund Financial Statements-Governmental Funds	
Balance Sheet	12-13
Reconciliation of the Governmental Funds Balance Sheet to Statement of Net Assets	14
Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)	15
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities . . .	16
Statement of Revenues and Expenditures - Budget and Actual - General and Debt Service Funds	17
Notes to Basic Financial Statements	18-43

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FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

TABLE OF CONTENTS (CONTINUED)

	<u>Pages</u>
PART II – SINGLE AUDIT SECTION	
Schedule of Expenditures of Federal Awards	44
Notes to Schedule of Expenditures of Federal Awards	45
Independent Auditor's Report on Compliance on Internal Control over Financial Reporting and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards . . .	46-47
Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	48-50
Schedule of Findings and Questioned Costs	51-65
Schedule of Status of Prior Year Audit Findings and Questioned Costs	66-67
PART III – CORRECTIVE ACTION PLAN	
Corrective Action Plan	



ORTIZ, RODRIGUEZ, RIVERA & CO.
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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of Loíza
Loíza, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Loíza, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Brisas de Loíza Project, as of June 30, 2004. Those financial statements were audited by other auditors whose report thereon has been furnished to, and our opinion, insofar as it relates to the amounts included for Brisas de Loíza Project, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, discretely presented component unit, each major fund and the aggregate remaining fund information of the Municipality of Loíza as of June 30, 2004, and the respective changes in financial position, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 8, 2005 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. 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 considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's 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 also not a required part of the basic financial statements. The schedule of expenditures of federal awards has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

San Juan, Puerto Rico
April 8, 2005

The stamp 2065368 was affixed
to the original of this report.



Ortiz Rodriguez, Rivera & Co

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management of the *Municipality of Loiza* of the Commonwealth of Puerto Rico (the "Municipality") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended **June 30, 2004**. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality's in the Governmental Activities has reported assets and net assets amounting to **\$9,982,038** and **(\$842,346)** respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to **\$6,575,674 (66 percent of total Municipality's assets)**.
- The Municipality in the same activities has reported total liabilities amounting to **\$11,912,952** in the accompanying statement of net assets, of which the most significant liabilities are bonds, notes and other long-term debt amounting to **\$6,937,269 (58 percent of total liabilities)**.
- The Municipality has reported total revenues amounting to **\$12,527,975** in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Gubernamental Funds, for the Fiscal Year Ended **June 30, 2004**. The most significant revenues amounting in this statement are property taxes and municipal licenses taxes and, licenses and permits were to **\$883,786 (7 percent of total revenues)** and **\$1,592,864 (13 percent of total revenues)**, respectively.
- The Municipality has reported a net change in net assets *deficiency* of revenues over expenditures amounting to **(\$1,668,688)** in the accompanying statement of activities.
- The Municipality's governmental funds reported combined ending fund balances of **(\$451,433)** which represent the fund balances of the general fund, capital projects funds and debt service fund combined (all known as the Municipality's major funds).
- The Municipality has reported a deficit for the general fund amounting to **(\$4,438,768)**.

- The Municipality has reported a deficiency of revenues and other financing sources over expenditures and other financing uses amounting to **(\$1,073,369)** in the governmental funds. Such amount correspond to General Fund, debt service and capital projects fund. As a significant fact, the Municipality's outlays for capital projects during the year amounted **\$242,141** while to the disponible funds provine of the fund balance available at beginning of the fiscal year. Such outlays over financing sources and reducing the expected income for the incongruence on the State economy were the principal reasons of the deficiency in the governmental funds.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Municipality's financial statements include three components: **(1)** the government-wide financial statements, **(2)** the fund financial statements, and **(3)** the notes to the financial statements (**collectively known as the basic financial statements**).

Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended **June 30, 2004** even if cash involved have not been received or paid. The government-wide financial statements include: **(1)** the statements of net assets and **(2)** the statement of activities.

Statement of Net Assets

The statement of net assets presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (**equity**). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended **June 30, 2004**. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (**such as uncollected taxes and earned but unused vacation leave**). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (**such as federal grants**). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

Fund Financial Statements

The Municipality's fund financial statements, which consist of: **(1)** the balance sheet – governmental funds and **(2)** the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. 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 fund financial statements focus on: **(1)** individual parts of the Municipality's government and **(2)** reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: **(1)** general fund, **(2)** debt service fund, **(3)** special revenue funds and **(4)** capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (**June 30, 2004**). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has four major funds: **(1)** the general fund **(2)** the debt service fund **(3)** the Housing and Urban Development Programs and **(4)** the Capiotal Projects Fund. .

Notes to the Basic Financial Statements

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

Government-wide Financial Statements Summary

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, liabilities exceeded assets by **(\$1,930,914)** at **June 30, 2004**.

As previously discussed, by far the largest portion of the Municipality's net assets reflect its investment in capital assets (**e.g., land, buildings, machinery, equipment and all other property**), less any related debt used to acquire those assets that is still outstanding. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. The following is a condensed presentation of the Municipality's financial position and results of operations,

as reported in the government-wide financial statements including its component unit, Brisas de Loiza Project:

Condensed Statement of Net Assets:

	<u>June 30, 2004</u>
Current assets	\$ 3,745,930
Capital assets	\$ 8,306,748
Total assets	<u>\$12,052,678</u>
Current liabilities	\$ 5,011,246
Non-current liabilities	\$ 9,037,434
Total liabilities	<u>\$14,048,680</u>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	\$ 2,143,674
Restricted	\$ 2,507,870
Unrestricted	\$ (6,647,546)
Total net assets	<u>(\$ 1,996,002)</u>

An additional portion of the Municipality's net assets (**3 percent**) represents resources that are subject to restrictions on how they may be used. At the end of the current fiscal year, the Municipality has reported positive balances in two categories of net assets.

Condensed Statement of Activities:

	<u>June 30, 2004</u>
Revenues:	
Program revenues:	
Charges for services	\$ 1,363,765
Operating grants and contributions	\$ 1,790,596
Capital grants and contributions	\$ 80,500
General revenues:	
Property taxes	\$ 883,786
Municipal license taxes	\$ 561,559
Grants and contributions	\$ 7,130,487
Interest, fines and penalties	\$ 54,889
Miscellaneous	\$ 985,663
Total revenues	<u>\$12,851,245</u>
Expenses:	
General government	\$ 6,345,769
Public safety	\$ 892,385
Public works	\$ 4,472,044

Recreation	\$ 379,452
Health and welfare	\$ 1,552,835
Depreciation expense	\$ 316,816
Interest on long-term debt	\$ 237,362
Brisas de Loiza Project	\$ 392,622
Total expenses	\$14,589,285
Change in net assets	\$ (1,738,040)
Net assets – at beginning of year	\$ 830,606
Net assets – at end of year	\$ (907,434)

Fund Financial Statements Summary

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

Governmental Funds - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

Condensed Balance Sheet – Governmental funds:

	<u>June 30, 2004</u>
Total Assets – Major Funds	\$ 4,410,781
Total Assets – Nonmajor Funds	\$ 84,151
Total assets	\$ 4,494,932
Total Liabilities – Major Funds	\$ 4,862,214
Total Liabilities – Nonmajor Funds	\$ 84,151
Total liabilities	\$ 4,946,365
Fund Balances – Major Funds	\$ (451,433)
Fund Balances – Nonmajor Funds	\$ -----0-----
Total Fund Balance	\$ (451,433)

Condensed Statement of Operations – Governmental funds:

Total Revenues – Major Funds	\$11,756,158
Total Revenues – Nonmajor Funds	\$ 771,817
Total revenues	\$12,527,975
Total expenditures – Major Funds	\$13,849,527
Total expenditures – Nonmajor Funds	\$ 771,817
Total expenditures	\$14,621,344
Other financing sources (uses) Major	\$ 1,020,000
Other financing sources (uses) Nonmajor	\$ -0-
Revenues Over Expenses – Major	\$(1,073,369)
Revenues Over Expenses – Nonmajor	\$ -0-
Total Fund Balance	\$(1,073,369)

Financial Contact

The Municipality's financial statements are designed to present users (**citizens, taxpayers, customers, investors and creditors**) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 2nd. floor of the **Loiza City Hall, Loiza, Puerto Rico.**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF NET ASSETS
JUNE 30, 2004**

<u>Assets</u>	<u>Governmental Activities</u>	<u>Brisas de Loiza Project</u>
Cash in bank (Note 2)	\$ 1,787,194	\$ 78,391
Cash with fiscal agent (Note 2)	1,044,558	
Accounts receivable		10,637
Due from other agencies (Note 8)	574,612	14,849
Restricted deposits		228,533
Inventories		7,156
Other assets		400
Capital assets, net (Note 10)	<u>6,575,674</u>	<u>1,730,674</u>
Total assets	<u>\$ 9,982,038</u>	<u>\$ 2,070,640</u>
<u>Liabilities and Net Assets</u>		
Liabilities		
Accounts payable and accrued liabilities	\$ 2,278,769	\$ 22,070
Deposits payable		13,493
Due to other agencies (Note 11)	1,198,370	
Deferred revenues (Note 12):		
Municipal license tax	237,107	
Federal government	172,869	
Noncurrent liabilities (Note 14):		
Due within one year	346,276	73,369
Due in more than one year	6,590,993	2,026,796
Total liabilities	<u>10,824,384</u>	<u>2,135,728</u>
Net Assets		
Investment in capital assets, net of related debt	2,143,674	
Restricted for:		
Debt service	1,459,963	
Capital projects	2,136,475	
Unrestricted	<u>(6,582,458)</u>	<u>(65,088)</u>
Total net assets	<u>\$ (842,346)</u>	<u>\$ (65,088)</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Governmental Activities	Component Unit Brisas de Loiza Project
Primary Government:						
General government	\$ 6,345,769	\$ 1,043,730	\$ -	\$ -	\$ (5,302,039)	\$ -
Public safety	892,385				(892,385)	
Public works	4,472,044			80,500	(4,391,544)	
Recreation	379,452				(379,452)	
Health and welfare	1,552,835		1,790,596		237,761	
Depreciation expense	316,816				(316,816)	
Interest on long-term debt	237,362				(237,362)	
Total primary government	\$ 14,196,663	\$ 1,043,730	\$ 1,790,596	\$ 80,500	(11,281,837)	
Component Unit:						
Brisas de Loiza Project	\$ 392,622	\$ 320,035	\$ -	\$ -		(72,587)
General revenues:						
Property taxes					883,786	
Municipal license tax					561,559	
Grants and contributions not restricted to specific programs					7,130,487	
Interest, fines and penalties					53,368	1,521
Miscellaneous					983,949	1,714
Total general revenues					9,613,149	3,235
Change in net assets					(1,668,688)	(69,352)
Net assets at beginning of year					826,342	4,264
Net assets at end of year					\$ (842,346)	\$ (65,088)

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Assets</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Note 2)	\$ 86,168	\$ 88,718	\$ 1,459,963	\$ 68,194	\$ 84,151	\$ 1,787,194
Cash with fiscal agent (Note 2)	13,907			1,030,651		1,044,558
Due from other agencies (Note 8)	573,749	863				574,612
Due from other funds (Note 9)				1,088,568		1,088,568
Total assets	\$ 673,824	\$ 89,581	\$ 1,459,963	\$ 2,187,413	\$ 84,151	\$ 4,494,932

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004

<u>Liabilities and Fund Balance (Deficit)</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities						
Accounts payable and accrued liabilities	\$ 2,197,650	\$ 863	\$ -	\$ 50,938	\$ -	\$ 2,249,451
Due to other agencies (Note 11)	1,198,370					1,198,370
Due to other funds (Note 9)	1,088,568					1,088,568
Deferred revenues (Note 12):						
Municipal license tax	237,107					237,107
Federal government		88,718			84,151	172,869
Total liabilities	<u>4,721,695</u>	<u>89,581</u>	<u>-</u>	<u>50,938</u>	<u>84,151</u>	<u>4,946,365</u>
Fund Balances (Deficit)						
Reserved for:						
Encumbrances	390,897					390,897
Debt service			1,459,963			1,459,963
Capital projects				2,136,475		2,136,475
Unreserved fund balance (deficit)	(4,438,768)					(4,438,768)
Total fund balance (deficit)	<u>(4,047,871)</u>	<u>-</u>	<u>1,459,963</u>	<u>2,136,475</u>	<u>-</u>	<u>(451,433)</u>
Total liabilities and fund balance (deficit)	<u>\$ 673,824</u>	<u>\$ 89,581</u>	<u>\$ 1,459,963</u>	<u>\$ 2,187,413</u>	<u>\$ 84,151</u>	<u>\$ 4,494,932</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2004**

Total fund balances - governmental funds	\$ (451,433)
Amounts reported for governmental activities in the statement of net assets are different because:	
• Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet	6,575,674
• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. (Note 4)	<u>(6,966,587)</u>
Net assets of governmental activities	<u>\$ (842,346)</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

	General	Housing and Urban Development Programs	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes (Note 6)	\$ 525,827	\$ -	\$ 357,959	\$ -	\$ -	\$ 883,786
Municipal license taxes (Note 7)	561,559					561,559
Licenses and permits	1,031,305					1,031,305
Charges for service and rents	12,425					12,425
Intergovernmental revenues (Note 13):						
Federal grants and contributions		1,394,119			396,477	1,790,596
State contributions	6,755,147			80,500	375,340	7,210,987
Interest, fines, and penalties	41,558		11,810			53,368
Other revenues	983,949					983,949
Total revenues	<u>9,911,770</u>	<u>1,394,119</u>	<u>369,769</u>	<u>80,500</u>	<u>771,817</u>	<u>12,527,975</u>
EXPENDITURES						
Current:						
General government	6,315,850					6,315,850
Public safety	1,032,606					1,032,606
Public works	3,237,812	1,234,232				4,472,044
Recreation	379,452					379,452
Health and welfare	621,131	159,887			771,817	1,552,835
Capital outlays				242,141		242,141
Debt service:						
Principal retirement			389,054			389,054
Interest and other			237,362			237,362
Total expenditures	<u>11,586,851</u>	<u>1,394,119</u>	<u>626,416</u>	<u>242,141</u>	<u>771,817</u>	<u>14,621,344</u>
Deficiency of revenues under expenditures	<u>(1,675,081)</u>	<u>-</u>	<u>(256,647)</u>	<u>(161,641)</u>	<u>-</u>	<u>(2,093,369)</u>
OTHER FINANCING SOURCES (USES)						
Loan proceeds	550,000			470,000		1,020,000
Transfers in	12,135		359,014			371,149
Transfers out	<u>(359,014)</u>		<u>(12,135)</u>			<u>(371,149)</u>
Total other financing sources (uses)	<u>203,121</u>	<u>-</u>	<u>346,879</u>	<u>470,000</u>	<u>-</u>	<u>1,020,000</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses	<u>(1,471,960)</u>	<u>-</u>	<u>90,232</u>	<u>308,359</u>	<u>-</u>	<u>(1,073,369)</u>
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR, AS RESTATED (Note 20)	<u>(2,575,911)</u>		<u>1,369,731</u>	<u>1,828,116</u>		<u>621,936</u>
FUND BALANCE (DEFICIT) AT END OF YEAR	<u>\$ (4,047,871)</u>	<u>\$ -</u>	<u>\$ 1,459,963</u>	<u>\$ 2,136,475</u>	<u>\$ -</u>	<u>\$ (451,433)</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Net change in fund balances - total governmental funds	\$(1,073,369)
Amounts reported for governmental activities in the statement of activities 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.	382,362
• Depreciation expense on capital assets is reported in the statement of activities, but do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds.	(316,816)
• Governmental funds report issuance of long-term debt as other financial sources because provides current financial resources.	(1,020,000)
• Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities.	389,054
• Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds.	<u>(29,919)</u>
Changes in net assets of governmental activities	<u><u>\$(1,668,688)</u></u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOIZA
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL-GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

	General Fund				Debt Service Fund			Variance with Final Budget- Positive (Negative)
	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts		Actual	
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 425,854	\$ 425,854	\$ 425,854	\$ -	\$ 329,463	\$ 329,463	\$ 357,959	\$ 28,496
Municipal license taxes	363,995	363,995	561,559	197,564				
Licenses and permits	2,272,703	2,272,703	1,031,305	(1,241,398)				
Charges for services and rent	10,000	10,000	12,425	2,425				
Intergovernmental revenues:								
State contributions	5,862,548	5,862,548	6,275,595	413,047				
Interest, fines and penalties	41,000	41,000	41,558	558	-	-	11,810	11,810
Other revenues	100,000	100,000	1,089,629	989,629				
Total revenues	<u>9,076,100</u>	<u>9,076,100</u>	<u>9,437,925</u>	<u>361,825</u>	<u>329,463</u>	<u>329,463</u>	<u>369,769</u>	<u>40,306</u>
EXPENDITURES								
Current:								
General government	5,417,516	4,743,914	4,399,384	344,530				
Public safety	1,188,416	1,188,416	967,950	220,466				
Public works	1,579,215	2,258,815	1,905,619	353,196				
Recreation	427,136	422,137	338,010	84,127				
Health and welfare	463,817	462,818	606,888	(144,070)				
Debt service:								
Principal					174,467	174,467	389,054	214,587
Interest					154,996	154,996	237,362	82,366
Total expenditures	<u>9,076,100</u>	<u>9,076,100</u>	<u>8,217,851</u>	<u>858,249</u>	<u>329,463</u>	<u>329,463</u>	<u>626,416</u>	<u>296,953</u>
Excess of revenues over (under) expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,220,074</u>	<u>\$ 1,220,074</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (256,647)</u>	<u>\$ (256,647)</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. ORGANIZATION

The Municipality of Loíza, Puerto Rico (Municipality) was founded in 1719. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial information of the Municipality is presented in this report as follows:

- **Management's Discussion and Analysis** - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- **Government - Wide Financial Statements** - The reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).
- **Statement of Net Assets** - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.

- **Statement of Program Activities** - The government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- **Budgetary comparison schedules** - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, "The Financial Reporting Entity", of the GASB. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exist for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The Brisas de Loíza Project is included in the basic financial statements as a discretely component unit because of the nature of the services they provide and the Municipality's ability to impose its will

Brisas de Loíza Project is a 70-unit multi-family housing project owned by the Municipality as authorized transfer from the Special Trustee for the Liquidation of the Accounts of the Puerto Rico Urban Renewal and Housing Corporation. The Project is operated under Section 221(d)(3) of USDA, Rural Development (USDA-RD) and regulated by the U. S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreements with HUD, and a significant portion of the Project's rental income is received from HUD. Also, the Project is financed by a Mortgage of Section 221 (d)(3) Direct Loan.

Separate financial statements of the individual component unit can be obtained from the respective administrative office.

Administrative office:
García de la Noceda Street
Loíza, Puerto Rico 00772

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

2) Housing and Urban Development Programs (HUD Programs)

This fund account for revenue sources for the development of viable urban communities, decent housing, suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low-income family.

3) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

4) Capital Projects Fund

This fund is used to account for the financial resources used for the acquisition and construction of major capital facilities, financed with the proceeds of general obligation bonds.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, licenses, permits, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions,

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

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

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. Interfund Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either due to/from other funds (i.e., the current portion of interfund loans) or advances to/from other funds (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as due to/from other funds.

f. Capital Assets

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

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

1) Encumbrances

Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

2) Debt Service

Represents net assets available to finance future debt service payments.

3) Capital Projects Fund

Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2004 amounted to approximately \$130,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$143,000 for workers compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

j. Use of Estimates

The preparation of 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
40	Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements.	2004-05
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2004-05
43	Financial Reporting for Post-employment Benefit Other than Pension Plans	2005-06
44	Economic Condition Reporting: The Statistical Section - an amendment on NCGA Statement I	2005-06
45	Accounting and Financial Reporting for Employers for Post-employment Benefits Other than Pensions	2009-10
46	Net Assets Restricted by Enabling Legislation	2005-06

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues over expenditures for the year ended June 30, 2004 is presented below for the general fund:

	General
Excess of revenues over expenditures - budgetary basis	\$1,220,074
Entity differences:	
Non- budgeted expenditures	(588,498)
Timing differences:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	(174,098)
Current year encumbrances recorded as expenditures for budgetary purposes	390,897
Basis of accounting differences:	
Net change in receivables	(121,201)
Net change in payables	(<u>2,402,255</u>)
 Excess of expenditures over revenues - GAAP basis	 <u>(\$1,675,081)</u>

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures; and principal and interest due for the debt service fund.

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

current period and therefore are not reported in the funds. The details of the approximately \$7.0 million difference are as follows:

Bonds payable	\$4,432,000
Compensated absences	1,218,383
Note payable to CRIM	882,241
Due to Puerto Rico Health Insurance Administration	182,962
Due to Puerto Rico Treasury Department	221,683
Other liabilities	<u>29,318</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$6,966,587</u>

5. DEPOSITS

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2004. Risk categories are described as follows:

Category 1: Deposit is insured or collateralized with securities held by the Secretary of the Treasury's agents in the Municipality's name.

Category 2: Deposit is collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.

Category 3: Deposit is uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

The Municipality's bank balances in commercial banks of approximately \$501,000 were fully collateralized at June 30, 2004 (Category 1).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The deposits at GDB of approximately \$1.03 million that are restricted principally for capital projects, and the \$1.5 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks (Category 3).

The Municipality maintains its investments in one (1) bank located at Puerto Rico. All kind of deposits are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.08% for real property and 6.08% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	< .20%>	< .20%>
	<u>8.08%</u>	<u>6.08%</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2003-04, but not the final settlement as the six months period after fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the final settlement already received, during the year ended June 30, 2004, the amount received in advances from CRIM exceeded the amount collected from taxpayers and charges by CRIM for the same period by approximately \$54,600. Such amount is presented as intergovernmental payable in the general fund in the basic financial statements (Refer to Note 11).

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2004. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of Loíza, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of Loíza, are as follows:

Savings and loans associations	= 1.00%
Financial institutions	= 1.50%
Other organization	= .50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$237,000, corresponding to the next fiscal year municipal license.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

8. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power of Authority	\$573,749
HUD - Section 8 Program	<u>863</u>
	<u>\$574,612</u>

9. INTERFUND TRANSACTIONS

a. Due from/to Other Funds

Due from/to other funds between the general fund and the capital project fund represents monies advanced for working capital purposes.

b. Interfund Transfers

Interfund transfers for the year ended June 30, 2004 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Debt Service	General	\$359,014
General	Debt Service	<u>12,135</u>
Total		<u>\$371,149</u>

The transfer from the General fund to the Debt Service fund represents receipts restricted as debt service payments become due. Transfer from the Debt Service fund to the General fund represents interest income generated by the bank account with GDB, which is remitted to the General fund for working capital purposes.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

10. CAPITAL ASSETS

a. Primary Government

Capital asset activity for the year ended June 30, 2004 was as follows:

	<u>Balance</u> <u>June 30, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2004</u>
Governmental Activities:				
Capital assets, not being depreciated:				
Land	\$ 1,628,017	\$ -	\$ -	\$ 1,628,017
Total capital assets, not being depreciated	<u>1,628,017</u>	<u>-</u>	<u>-</u>	<u>1,628,017</u>
Capital assets, being depreciated:				
Buildings and building improvements	4,988,000			4,988,000
Furniture and fixtures	282,385	67,870	5,097	345,158
Vehicles and equipment	1,526,860	314,492		1,841,352
Infrastructure	1,538,717			1,538,717
Total capital assets, being depreciated	<u>8,335,962</u>	<u>382,362</u>	<u>5,097</u>	<u>8,713,227</u>
Less accumulated depreciation for:				
Buildings and building improvements	1,884,711	108,643		1,993,354
Furnitures and fixtures	204,402	49,219	5,097	248,524
Vehicles and equipment	1,213,767	128,180		1,341,947
Infrastructure	150,971	30,774		181,745
Total accumulated depreciation	<u>3,453,851</u>	<u>316,816</u>	<u>5,097</u>	<u>3,765,570</u>
Total capital assets, being depreciated, net	<u>4,882,111</u>	<u>65,546</u>	<u>-</u>	<u>4,947,657</u>
Governmental activities capital assets, net	<u>\$ 6,510,128</u>	<u>\$ 65,546</u>	<u>\$ -</u>	<u>\$ 6,575,674</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

b. Discretely Presented Component Unit

Activity for Brisas de Loíza Project for the fiscal year ended June 30, 2004 was as follows:

	Balance June 30, 2003	Increases	Decreases	Balance June 30, 2004
Capital assets, not being depreciated:				
Land	\$ 109,735	\$ -	\$ -	\$ 109,735
Total capital assets, not being depreciated	<u>109,735</u>	<u>-</u>	<u>-</u>	<u>109,735</u>
Capital assets, being depreciated:				
Land improvements	198,276			198,276
Buildings and building improvements	2,625,144	13,931		2,639,075
Building equipment	177,213	1,884		179,097
Furniture and fixtures	30,710	10,254		40,964
Equipment	34,727	5,556		40,283
Total capital assets, being depreciated	<u>3,066,070</u>	<u>31,625</u>	<u>-</u>	<u>3,097,695</u>
Less accumulated depreciation for:				
Land improvements	130,096	4,911		135,007
Buildings and building improvements	1,090,061	92,289		1,182,350
Building equipment	101,689	7,700		109,389
Furnitures and fixtures	29,129	3,550		32,679
Equipment	12,981	4,350		17,331
Total accumulated depreciation	<u>1,363,956</u>	<u>112,800</u>	<u>-</u>	<u>1,476,756</u>
Total capital assets, being depreciated, net	<u>1,702,114</u>	<u>(81,175)</u>	<u>-</u>	<u>1,620,939</u>
Brisas de Loíza Project capital assets, net	<u>\$ 1,811,849</u>	<u>\$ (81,175)</u>	<u>\$ -</u>	<u>\$ 1,730,674</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

11. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2004 are as follows:

Puerto Rico Electric Power Authority	\$ 546,976
Puerto Rico Treasury Department	260,559
Retirement System Administration	200,751
CRIM	54,608
Puerto Rico Labor Department	50,691
State Insurance Fund Corporation	48,001
General Services Administration	22,908
Puerto Rico Water and Sewer Authority	<u>13,876</u>
Total	<u>\$1,198,370</u>

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately \$237,000 municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

b. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant. These were related to the following federal programs/grants:

Program/Grant Description

Urban Development Action Grant (HUD)	\$ 63,978
SBGP (HUD)	22,938
Housing Opportunities for Persons with AIDS (HUD)	1,802
Other governmental funds	<u>84,151</u>
Total	<u>\$172,869</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

13. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

14. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2004 are as follows:

a. Bonds

\$451,000 series of 1993, payable in annual installments of \$10,000 to \$32,000 until January 1, 2016, interest at 5%.	\$ 299,000
\$100,000 series of 1996, payable in annual installments of \$3,000 to \$8,000 until January 1, 2015, interest at 4.5%.	68,000
\$385,000 series of 1999, payable in annual installments of \$40,000 to \$70,000 until July 1, 2007, interest ranging from 7.81% to 8%.	250,000
\$1,685,000 series of 1999, payable in annual installments of \$30,000 to \$150,000 until July 1, 2023, interest ranging from 5.88% to 8%.	1,595,000
\$655,000 series of 2002, payable in annual installments of \$5,000 to \$20,000 until July 1, 2026, interest ranging from 5% to 8%.	640,000
\$870,000 series of 1987, payable in annual installments of \$15,000 to \$90,000 until July 1, 2006, interest at 8.5%.	245,000
\$400,000 series of 1997, payable in annual installments of \$10,000 to \$40,000 until July 1, 2016, interest at 6.75%.	315,000
\$130,000 series of 2004, payable in annual installments of \$5,000 to \$10,000 until July 1, 2028, interest ranging from 5.0% to 6.5%.	130,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

\$340,000 series of 2004, payable in annual installments of \$40,000 to \$60,000 until July 1, 2010, interest ranging from 5.0% to 6.5%.	\$ 340,000
\$95,000 series of 2004, payable in annual installments of \$2,000 to \$7,000 until July 1, 2028, interest ranging from 5.0% to 6%.	95,000
\$455,000 series of 2004, payable in annual installments of \$5,000 to \$35,000 until July 1, 2028, interest ranging from 5.0% to 6.5%.	<u>455,000</u>
Total bonds payable	<u>\$4,432,000</u>

b. Note Payable

Note payable of \$882,241 represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate principal installments of \$33,347 including interest rate of 6.187%.

The annual debt service requirements for the bonds payable and note payable at June 30, 2004, are as follows:

	Bonds		Note Payable	
	Principal	Interest	Principal	Interest
2005	\$ 266,000	\$ 212,721	\$ 12,296	\$ 54,401
2006	282,000	239,095	13,069	53,629
2007	313,000	221,839	13,890	52,808
2008	245,000	205,770	14,763	51,935
2009	176,000	195,270	15,691	51,007
2010-2014	893,000	866,061	94,536	238,951
2015-2019	872,000	564,137	128,209	205,274
2020-2024	1,008,000	297,167	173,877	159,608
2025-2029	377,000	56,919	235,813	97,674
2030-2034	-	-	180,097	19,966
	<u>\$4,432,000</u>	<u>\$2,858,979</u>	<u>\$882,241</u>	<u>\$985,253</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

c. Other Long-Term Liabilities

1) Due to Puerto Rico Health Insurance Administration

Due to Puerto Rico Health Insurance Administration represents the municipal contributions related to the Health Care Reform corresponding to the period from December 1, 1995 through June 30, 1997. This balance will be paid through amounts withheld by the CRIM from the participation in the Municipal Equalization Fund of the Additional Lottery System.

2) Due to Puerto Rico Treasury Department

Due to Puerto Rico Treasury Department represents property tax advances, payable in monthly installments of \$2,639 until 2009.

As described in Note 6, the Municipality levies an annual special tax of 1.48% of the assessed value of real property. The proceeds of this tax are required to be credited to the Debt Service fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected and retained by the CRIM.

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
Governmental Activities:					
Bonds payable	\$ 3,594,170	\$ 1,020,000	\$ 182,170	\$ 4,432,000	\$ 266,000
Advances from CRIM	904,697		22,456	882,241	12,296
Total governmental activities	<u>4,498,867</u>	<u>1,020,000</u>	<u>204,626</u>	<u>5,314,241</u>	<u>278,296</u>
Other long-term liabilities:					
Due to Puerto Rico Health Insurance Administration	262,443		79,481	182,962	-
Due to Puerto Rico Treasury Department	260,029		38,346	221,683	
Due to Puerto Rico Labor Department	66,601		66,601	-	
Compensated absences	1,188,464	96,230	66,311	1,218,383	67,980
Total other long-term liabilities	<u>1,777,537</u>	<u>96,230</u>	<u>250,739</u>	<u>1,623,028</u>	<u>67,980</u>
Total noncurrent liabilities, governmental activities	<u>\$ 6,276,404</u>	<u>\$ 1,116,230</u>	<u>\$ 455,365</u>	<u>\$ 6,937,269</u>	<u>\$ 346,276</u>
Component Unit:					
Brisas de Loiza Project mortgage payable	<u>\$ 2,116,211</u>	<u>\$ -</u>	<u>\$ 16,046</u>	<u>\$ 2,100,165</u>	<u>\$ 73,369</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

15. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. ERS was created under the ACT 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of 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.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

(55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions'

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2004 was approximately \$135,000. The Municipality's payroll for employees covered by ERS was approximately \$1.4 million. The Municipality total payroll for all employees was approximately \$4.8 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2004, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

16. RISK MANAGEMENT

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

17. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in the Transportation Center under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2004 was approximately \$12,000.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Leasing arrangements with the Municipality as lessee:

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

18. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.
- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

19. COMMITMENTS

The Municipality of Loíza had several outstanding or planned construction projects as of June 30, 2004. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$1.04 million.

20. RESTATEMENTS

The Municipality of Loíza has restated the beginning fund balance of other governmental funds to correct expenses not previously recorded.

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

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U. S. Department of Housing and Urban Development (HUD)		
Direct programs:		
Section 8-Housing Choice Vouchers	14.871	\$ 46,166
Pass-through State - Commissioner Office of Municipal Affairs		
Community Development Block Grant-State Program SBGP	14.228	1,234,232
Pass-through Municipality of San Juan Housing Opportunities for Persons with AIDS (HOPWA)	14.241	<u>113,721</u>
Subtotal U. S. Department of HUD		<u>1,394,119</u>
U. S. Department of Health and Human Services (HHS)		
Pass-through Puerto Rico Family Department Child Care and Development Block Grant	93.575	<u>147,318</u>
Subtotal U. S. Department of HHS		<u>147,318</u>
U. S. Department of Agriculture		
Pass-through Puerto Rico Education Department- Child and Adult Care Food Program	10.558	<u>48,234</u>
Subtotal U. S. Department of Agriculture		<u>48,234</u>
TOTAL		<u>\$1,589,671</u>

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

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is a summary of the activity of the Loíza's federal award programs presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

2. RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

Expenditures per basic financial statements:

Housing and Urban Development programs	\$1,394,119
Less federal expenditures included within the Other nonmajor governmental funds	<u>195,552</u>
Expenditures per Schedule of Expenditures of Federal Awards	<u>\$1,589,671</u>



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Services Division

INDEPENDENT AUDITOR'S 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

To the Honorable Mayor and
Municipal Legislature
Municipality of Loíza
Loíza, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Loíza as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated April 8, 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Municipality of Loíza's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider 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 judgment, could adversely affect the Municipality of Loíza's 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 a, b, and c.

A material weakness is a reportable 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 error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items a, b, and c to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of Municipality of Loíza, in a separate letter dated April 8, 2005.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Loíza's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items a thru i.

This report is intended solely for the information and use of the audit committee, Commissioner Office of Municipal Affairs, management and the 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.

San Juan, Puerto Rico
April 8, 2005

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to the original of this report.





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

To the Honorable Mayor
and Municipal Legislature
Municipality of Loíza
Loíza, Puerto Rico

Compliance

We have audited the compliance of Municipality of Loíza 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 Loíza's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Loíza's management. Our responsibility is to express an opinion on Municipality of Loíza's compliance based on our audit.

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

This report is intended solely for the information and use of the audit committee, Commissioner Office of Municipal Affairs, management and the 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.

San Juan, Puerto Rico
April 8, 2005

Ortiz, Rodriguez, Rivera & Co

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to the original of this report.



our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Municipality of Loíza's compliance with those requirements.

As described in items 04-1 to 04-4 in the accompanying schedule of findings and questioned costs, the Municipality of Loíza's did not comply with the requirements regarding cash management, reporting and activities allowed or unallowed; allowable costs/cost principle that are applicable to Community Development Block Grants/States Program (SBGP). Compliance with such requirements is necessary in our opinion for the Municipality of Loíza to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, Municipality of Loíza 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.

Internal Control over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Municipality of Loíza's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 04-3 to 04-4.

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 the applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 04-3 to be a material weakness.

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

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expresses an unqualified opinion on the financial statements of the Municipality of Loíza.
- b. There were reportable conditions on internal controls some of which are considered to be material weaknesses.
- c. Instances of noncompliance material to the financial statements of Municipality of Loíza were disclosed during the audit.
- d. There were reportable conditions on internal controls over major programs, of which one is considered to be a material weakness.
- e. The auditor's report on compliance for the major federal award programs for Municipality of Loíza express a qualified opinion.
- f. Audit findings relation to the major federal award programs for Municipality of Loíza are reported in number 3 of this schedule.
- g. The programs tested as major programs included:

Community Development Block Grants/States Program SBGP - CFDA No. 14.228
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Loíza was determined to be a high-risk auditee.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

a. General Ledger

The Municipality does not have the accounting practices, policies or internal controls in place to provide for the preparation of financial statements, on a timely basis, in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). The accounting system does not provide for a self balancing set of accounts for each fund operated by the Municipality, recording cash and other financial resources, together with all related assets, liabilities, revenues, expenditures and changes in fund balances. Therefore, the financial statements must be prepared using financial information obtained from various departments and accounting records. The records are not integrated, and do not follow a double entry system (debits and credits). As a result, the records required significant adjustments in order to present the financial position and results of operations of the Municipality in conformity with generally accepted accounting principles.

The continued failure to have an adequate accounting system prevents the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions when plans and objectives are not being met.

Recommendation

The Municipality should adopt and implement a plan to convert its accounting system to an integrated system that would allow for the monthly closing of the general ledger, as well as the preparation of year-end financial statements in accordance with generally accepted accounting principles.

This plan should provide for:

- 1) Assessment of the financial accounting and reporting needs in order to take the necessary steps to meet the financial reporting requirements of GASB Statement No. 34.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

- 2) The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for the federal funds.
 - 3) The preparation of periodic financial reports to be submitted to the Finance Director and all other interested entities.
 - 4) Adequate training of all accounting personnel to improve the understanding of the system and to promote operational efficiency.
 - 5) Reconciliation of financial records with the reports prepared and submitted to the federal government.
- b. The Municipality does not have a reliable financial reporting system that ensures the preparation and submission of the Budgetary Liquidation to the Municipal Affairs Commissioner's Office on or before September 30 of each year. This condition results from the failure of the Municipal management to monitor compliance with the required reporting requirements by ensuring the timely preparation and submission of financial reports.

Recommendation

The Municipality should establish reporting calendar which informs to the Municipality's management of the due dates of each financial report. Chapter II, Section 10 of the Basic Standards requires to the Finance Director to prepare and submit to the Municipal Affairs Commissioner's Office the Budgetary Liquidation on or before September 30.

c. Budget

The Municipality's system of internal control relating to the Budgeting function does not adequately prevent operating management from incurring expenditures in excess of the level of funds appropriated and available. The Municipality closed its fiscal year ended June 30, 2004 with an unreserved fund balance deficiency in the general fund approximately \$4.4 million.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

This occurs because the budgeting system does not reflect actual available revenues and therefore cannot prevent the obligation of expenditures for which current resource will not be available.

Article 8.004 (b) of the Municipalities Law establishes that the Municipality cannot obligate or spend funds in excess of the appropriations or the ensuing fiscal year. In addition, according to Chapter IV, Section 17, of the Basic Standards, the responsibility of oversight to prevent deficits in any municipal fund rest with the Finance Director.

The continued occurrence of this situation could result in the eventual reduction or elimination of municipal services since future revenues will need to be used to pay for accumulated liabilities.

Recommendation

The Municipality should revise and amend the budget as current information related to collections of budgeted revenues became available.

d. Cash

- 1) The Municipality is not canceling outstanding checks, which have been outstanding for a period in excess of one year. Our testing of selected bank reconciliations revealed that there are 76 outstanding checks in the accounts totaling \$41,186.28 as of June 30, 2004 which have been outstanding for more than one year as detailed below:

<u>Account Name</u>	<u>Account Number</u>	<u>Number of Checks</u>	<u>Total Amount</u>
Cuenta Corriente	308-010540	73	\$40,192.78
SENDEC	308-010602	1	772.50
SBGP	308-010568	1	178.00
Sección 8	308-010531	1	43.00
			<u>\$41,186.28</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

This is caused by the lack of a regular monthly review and follow up of bank reconciliations, specifically those with many outstanding checks, and the need to establish investigation procedures to determine the underlying reasons as to why these checks have not been presented for payment.

Although Chapter IV, Section 11, of the Basic Standards establishes that checks outstanding for more than one year should be cancelled and the amount included in the cash balance, municipal checks are not valid six months after being issued.

This situation represents a possible understatement of cash and an overstatement of expenditures and, in the case of federal funds, could result in questioned and disallowed costs.

Recommendation

The Municipality should evaluate the outstanding check lists on a monthly basis, and investigate checks that have not cleared the bank for an unreasonable period of time (i.e. three to six months), contact the payee and determine the underlying reasons as to why these have not been presented to the bank for payment.

- 2) Bank reconciliations were not prepared and reviewed on a timely basis. In addition, the year end bank reconciliations included various reconciling items related to prior years which are still pending to be posted to the general ledger.

<u>Account Name</u>	<u>Account Number</u>	<u>Differences</u>
Cuenta Corriente	308-010540	\$130,440.97
SENDEC	308-010602	1,956.73
SBGP	308-010568	3,974.15
Sección 8	308-010531	2,807.21
Departamento del Trabajo	308-010611	36.72
Huracán Georges	308-001462	(10.00)
Fondos Planes Emergencias	308-0-11665	8.12
E.D.A.	308-0-10577	4.23
UDAG	308-10595	96.11
Aportaciones Estatales	308-000007	5,604.72

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Account Name</u>	<u>Account Number</u>	<u>Differences</u>
HOPWA	308-001426	\$ (18.27)
Aportación de Padres	308-010620	5.68
Child Care Food Program	308-010639	9.72

Recommendation

Bank reconciliations should be prepared and reviewed on a timely basis in order to identify errors or adjustments and correct them. This is extremely important given that the Municipality may not be able to prevent or detect, on a timely basis, errors, irregularities or illegal acts that may occur. Therefore, the Municipality is exposed to a significant risk of loss of funds.

e. Disbursement Test

The Municipality's system of internal control over purchasing and payments is not effectively ensuring the completeness of vouchers for payments and related documentation. For the following payments, the disbursement vouchers were not available for our test.

<u>Date</u>	<u>Payee</u>	<u>Check Number</u>	<u>Check Amount</u>
10-06-03	Office Gallery	738	\$ 1,380.62
07-11-03	Constructora 2004, Inc.	969	11,894.32
02-17-03	Electromecánica Tony	1021	975.00
11-18-03	Carlos J. Matos	1158	900.00

Recommendation

Chapter IV, Section 12 of the Basic Standards requires that vouchers payments, canceled checks and any other document that justify a payment should be filed by the Finance Director to be audited by the Comptroller's Office as required by Rule No. 23, Supplement 17, approved by the Secretary of Treasury on October 25, 1962.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

- f. The Municipality's system of internal control over purchasing and payments is not effectively ensuring that disbursements include all approvals required. The following disbursements vouchers lack of some required approvals:

<u>Date</u>	<u>Check Number</u>	<u>Check Amount</u>
07-16-03	27823	\$ 2,299.00
08-20-03	28002	600.00
08-21-03	28017	2.00
08-22-03	28022	972.08
09-15-03	28103	2,325.00
09-22-03	28199	1,860.00
11-04-03	772	1,261.75
11-21-03	773	855.00
02-18-04	781	1,444.77

Recommendation

We recommend the Municipality establish procedures to ensure that all related approvals be obtained as required by Chapter IV, Section 1 and 4 of the Basic Standards.

g. Payroll

The following personnel files do not include the Form I-9, Eligibility of Employment.

<u>Social Security No.</u>	
584-56-4746	583-35-1042
584-43-3997	581-11-5943
583-42-5496	584-94-3413
583-68-1898	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Recommendation

We recommend the Human Resources Department to request the employees the corresponding documents to fulfill the requirements established in the Autonomous Municipalities Law, Article 12.

h. Municipal License Tax

During our audit we selected a sample of 25 files to examined the Volume of Business Declaration. In our examination we noted the following situations:

- 1) Three (3) taxpayers files were not available for our procedures. (Simking Industries, McDonald System and Oscar Medina).
- 2) One (1) taxpayer return includes revenues over one million and not include the audited financial statements. (Centro Vacacional UIA)
- 3) One (1) taxpayer paid based on the net income, not in the gross revenues. (Centro Vacacional UIA)

Chapter IX of the Basic Standards establishes the procedures to be followed for filing and collection the municipal license taxes. This is mainly due to the fact that the Municipality is not properly reviewing the municipal license tax returns when received. The continued failure to verify the correctness of the Volume of Business Declarations filed by the taxpayers prevents the Municipality from collecting the correct amount of taxes.

Recommendation

The Municipality should train and assign a person to the Municipal License Tax Department that could perform the required procedures and will follow up to taxpayers that did not comply with the law.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

i. Construction Excise Tax

The Municipality could not provide us 2 files related to construction excise tax from a sample of 11 files.

<u>Date of the Receipt</u>	<u>Official Receipt Number</u>	<u>Amount</u>
08-07-03	8061	\$10,400.00
10-22-03	8355	9,191.25

In addition, the Municipality could not provide the documentation to evidence the final construction cost of River Stone Corporation with the official receipt number 8091 for \$34,000 dated July 18, 2003.

Article 2.007 of the Autonomous Municipalities Law establishes that the person responsible of the realization of the project should file to the Finance Department of the Municipality an Activity Declaration that describe the costs of the project to be realized. In addition, Chapter III, Section of the Basic Standards establish that the Finance Director will be responsible for safeguarding and keep the documents and files available for examination of the Comptroller's Office of Puerto Rico and the Municipal Affairs Commissioner's Office.

The continued failure to maintain adequate documentation of construction excise tax files prevents the Municipality from having current accurate and reliable reports.

Recommendation

The Municipality should ascertain that adequate source documentation of construction excise tax files exist to support any amounts reported in the Municipality's books.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
SBGP CFDA No. 14.228	<p>Condition 04-1</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.</p> <p><u>Cause</u></p> <p>The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.</p> <p><u>Effect</u></p> <p>The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>									
	<p style="text-align: center;"><u>Recommendation</u></p> <p>The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.</p>										
	<p style="text-align: center;">Condition 04-2</p> <p>The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis. During our examination of the Federal Financial Reports, we noted that the Municipality did not send on time the quarterly report for the following period ended:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;"><u>Quarter Ended</u></th> <th style="text-align: center;"><u>Due Date</u></th> <th style="text-align: center;"><u>Date Submitted</u></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">12-2003</td> <td style="text-align: center;">01-30-04</td> <td style="text-align: center;">02-06-04</td> </tr> <tr> <td style="text-align: center;">06-2004</td> <td style="text-align: center;">07-30-04</td> <td style="text-align: center;">08-10-04</td> </tr> </tbody> </table> <p><u>Criteria</u></p> <p>The Municipality is not in compliance with 43 CFR 13.41-(b)(3) which requires federal fund recipients to periodically monitor the performance of grant-supported activities to ensure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved by the</p>	<u>Quarter Ended</u>	<u>Due Date</u>	<u>Date Submitted</u>	12-2003	01-30-04	02-06-04	06-2004	07-30-04	08-10-04	\$ <u>-0-</u>
<u>Quarter Ended</u>	<u>Due Date</u>	<u>Date Submitted</u>									
12-2003	01-30-04	02-06-04									
06-2004	07-30-04	08-10-04									

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p>preparation of federal financial reports. To achieve these goals, program management should prepare accurate and timely federal financial reports.</p> <p><u>Cause</u></p> <p>The above situation occurred because the Municipality did not ensure to verify and understand its reporting requirements for this program.</p> <p><u>Effect</u></p> <p>The continued failure to file the required reports may result in sanctions by the Federal grantor, such as grant payment withholdings.</p> <p><u>Recommendation</u></p> <p>The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially with new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.</p>	
<p>SBGP CFDA No. 14.223</p>	<p>Condition 04-3</p> <p>In order to test the allowability of the disbursements for the fiscal year ended June 30, 2004, we selected 25 disbursements which</p>	<p><u>\$260,024</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
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totalled \$896,811.69 or 64% of the program. The Municipality could not provide adequate supporting documentation in 3 out of the 25 disbursements tested, or 29% of our sample, amounting to \$260,024 as follows:

<u>Check Number</u>	<u>Payee</u>	<u>Date</u>	<u>Amount</u>	<u>Information not Available</u>
2898	Yazmín Nieves Colomer	08-11-03	\$ 33,600	Purchase order
2904	Suzuki del Caribe	08-13-03	17,950	Purchase order/ invoice
2929	Constructora 2004, Inc.	10-06-03	208,474	Purchase order

Criteria

As per OMB A-87, to be allowable under federal awards, costs must be adequately documented. In addition, 24 CFR (b) requires that except as otherwise provided, records must be retained for three years starting the day the grantee submits to the awarding agency its expenditure report.

Cause

The Municipality does not keep adequate internal control procedures regarding the filing of documents.

Effect

Failure to maintain adequate accounting records may result in disallowance of costs by the awarding agency.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p style="text-align: center;"><u>Recommendation</u></p> <p>The Municipality's management should ascertain that adequate source documentation exists to support amounts and items reported as expenditures. The Municipality should also establish a record keeping system to ensure that accounting records and documentation are retained for the time period required by applicable requirements and the provisions of laws, regulations, contracts or grant agreements applicable to the program.</p>	
<p>SBGP CFDA No. 14.223</p>	<p>Condition 04-4</p> <p>The Municipality has deficiencies in the execution of property management procedures. During our test of real property and equipment management, we found that the Municipality does not perform a reconciliation of the physical inventory with the accounting records. In addition, equipment acquired during the year is not properly labeled and identified.</p> <p><u>Criteria</u></p> <p>As per CFR 24, Part 85.32 (4)(d) property records shall be accurately maintained. The records should include, for each item of equipment, a description of the equipment including serial number, an identification number, identification of the grant under which the recipient acquired the equipment, the information needed to calculate the federal share of the equipment, the acquisition date and unit acquisition cost, the location, use</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p>and condition of the equipment. In addition, states that every two years, at a minimum, a physical inventory should be conducted and the results should be reconciled with the property records to verify the existence, current utilization, and continued need for th equipment. Any discrepancies between quantities determined by the physical inspection and those shown in the accounting records should be investigated to determine the causes of the differences.</p> <p><u>Cause</u></p> <p>The Municipality does not maintain accurate records for acquisitions and dispositions for property acquired with federal awards.</p> <p><u>Effect</u></p> <p>The Municipality is exposed to the risk of possible unauthorized use and disposition of equipment due to the lack of internal controls and adequate property and equipment records. The possible misappropriation of the equipment acquired with federal funds could result in disallowed costs.</p> <p><u>Recommendation</u></p> <p>The Municipalities' management should determine that proper procedures are in place to ensure that property purchased with federal funds is identified and conduct periodic inventories and follow up an inventory discrepancies. In addition, the Municipality's management should review all dispositions of property to ensure appropriate valuation and reimbursement to federal awarding agencies.</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LOÍZA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
SBGP CFDA No. 14.228	Condition 03-1	
	This program maintains a high balance in cash.	Condition still continues.
	Condition 03-2	
	The program did not file on time the quarterly reports.	Condition still continues.
	Condition 03-3	
	The program does not keep adequate internal control procedures regarding the filing of documents.	Condition still continues.

EXHIBIT I

CORRECTIVE ACTION PLAN

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562



Estado Libre Asociado de Puerto Rico

Gobierno Municipal

*G.P.O. Box 508
Loíza, Puerto Rico 00772*

Teléfonos. 876-1040

876-3570

876-3536

Director de Finanzas

CORRECTIVE ACTION PLAN

April 18, 2005

Cognizant or Oversight Agency for audit.:

Municipality of Loíza respectfully submits the following corrective action plan for the year ended June 30, 2004.

Name and address of independent public accounting firm: Ortiz, Rodríguez, Rivera & Co., Suite 152, P.O. Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2004

The findings from the June 30, 2004 Schedule of Findings and Questioned Costs are discussed bellow. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS-FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Finding 04-01: SBGP-CFDA 14.228

Reportable Condition: See Condition 04-1

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Municipality already established procedures to coordinate efficiently the request of funds in order to disburse immediately after receipt or within three business days.

" Loíza Capital de las Tradiciones "

Finding 04-2: SBGP – CFDA 14.228

Reportable Condition: See Condition -04-2

Recommendation

The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially with new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance (“CFDA”), which is available from the federal government.

Action Taken

The Municipality is taking all the necessary procedures to become familiar with all administrative requirements in order to file all the required reports on time.

Finding 04-3: SBGP – CFDA

Reportable Condition: See Condition 04-3

Recommendation

The Municipality’s management should ascertain that adequate source documentation exists to support amounts and items reported as expenditures. The Municipality should also establish a record keeping system to ensure that accounting records and documentation are retained for the time period required by applicable requirements and the provisions of laws, regulations, contracts or grant agreements applicable to the program.

Action Taken

The Municipality is identifying the reasons for the missing documents and establishing control procedures for an adequate filing system.

Finding 04-4: SBGP 14.228

Reportable Condition: See Condition 04-4

Recommendation

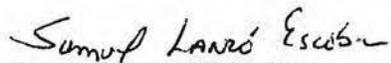
The Municipalities’ management should determine that proper procedures are in place to ensure that property purchased with federal funds is identified and conduct periodic inventories and follow up an inventory discrepancies. In addition, the Municipality’s management should review all dispositions of property to ensure appropriate valuation and reimbursement to federal awarding agencies.

Action Taken

The Office of Internal Auditing is working on a physical inventory of the state and Federal property, to ensure that all property is properly identified and conduct periodic inventories within the year.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Mr. Onix Ortiz, Finance Director, at (787) 256-1525.

Sincerely yours,


Samuel Lanzó Escobar
Temporary Finance Director