

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

MUNICIPIO DE LUQUILLO
AUDITORIA 2002-2003
30 DE JUNIO DE 2003

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DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF LUQUILLO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2003

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF LUQUILLO

YEAR ENDED JUNE 30, 2003

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF LUQUILLO

YEAR ENDED JUNE 30, 2003

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López-Vega, CPA, PSC

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

INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Luquillo
Luquillo, 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 Luquillo**, Puerto Rico, as of and for the year ended June 30, 2003, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

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

As described in Note 1, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-for States and Local Governments, and has adopted paragraphs six to eleven of GASB Statement No. 38, Certain Financial Statements Note Disclosures, as of June 30, 2003.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

In addition, the Municipality adopted a prospective reporting of its general infrastructure assets.

The Management's Discussion and Analysis on pages 3 through 10 and the Budgetary Comparison Schedule-General Fund on page 39 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2003 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 and grants.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 18, 2003

Stamp No. 1942308 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT AND DISCUSSION ANALYSIS

YEAR ENDED JUNE 30, 2003

Management's Discussion and Analysis

Management of the Municipality of Luquillo (the "Municipality") implemented Statement No. 34 ("Statement") of the Governmental Accounting Standards Board ("GASB"), Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments for the fiscal year ended on June 30, 2003. This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of such Statement, and it has been designed accordingly with the following goals:

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

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

FINANCIAL HIGHLIGHTS

- The Municipality net assets decreased by \$ 1,341,488.
- In the fund financial statements, the governmental activities revenue increased \$ 90,455 while governmental activities expenditures increased \$ 2,158,574 (or 25%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$ 611,943.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$ 89,215.
- The Municipality issued bonds amounting to \$4,430,000 to finance the capital projects.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Using This Annual Report

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Asset presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements, focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Fund Financial Statements (Continued)

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Infrastructure Assets

Historically, a government's largest group of assets (infrastructure-roads, bridges, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the Governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrated its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

The Municipality commenced the reporting of infrastructure assets during the current year. Also, the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's combined net assets (excess of assets over liabilities) totaled \$ 10,606,887 at the end of 2003, compared to \$11,948,375 at the end of the previous year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Net Assets (Continued)

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Condensed Statement of Net Assets
June 30, 2003

Current assets	\$ 9,205,999
Capital assets	<u>12,234,303</u>
Total assets	<u>21,440,302</u>
Current liabilities	1,511,163
Noncurrent liabilities	<u>9,322,252</u>
Total liabilities	<u>10,833,415</u>
Invested in capital assets, net of related debt	6,578,303
Restricted	6,173,779
Unrestricted (deficit)	<u>(2,145,195)</u>
Total net assets	<u>\$10,606,887</u>

Changes in Net Assets

The Municipality's net assets decreased by \$ 1,341,488. Approximately 50 percent of the Municipality's total revenue came from taxes, while 46 percent resulted from grants and contributions, including federal aid. Charges for Services provided less than 1 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works, health and welfare, culture and recreation, community development, economic development and public safety. In future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Changes in Net Assets (Continued)

Condensed Statement of Activities
June 30, 2003 -

Program revenues:	
Charges for services	\$ 86,952
Operating grants and contributions	1,683,041
Capital grants and contributions	118,587
General revenues:	
Property taxes	3,456,412
Municipal license tax	725,092
Grants and contributions not restricted to specific programs	2,507,181
Other local taxes	456,059
Interest and investment earnings	78,668
Miscellaneous	<u>75,670</u>
Total revenues	<u>9,187,662</u>
Expense:	
General government	4,554,241
Public safety	63,574
Public works	2,725,523
Culture and recreation	471,750
Health and welfare	2,042,843
Community development	322,485
Economic development	231,477
Interest on long-term debt	<u>117,257</u>
Total expenses	<u>10,529,150</u>
Change in net assets	(1,341,488)
Net assets, beginning of year	<u>11,948,375</u>
Net assets, end of year	<u>\$ 10,606,887</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$7,694,836, an increase of \$3,405,333 in comparison with the prior year. There are reservations of fund balance amounting to \$6,480,744. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$306,965), 2) to pay debt service (\$1,318,315), 3) to pay for capital projects (\$4,480,816) and 4) for other purposes (\$374,648).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2003, the general fund has a fund balance of \$1,521,057.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT AND DISCUSSION ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2003, amounts to \$ 17,610,696, net of accumulated depreciation of \$ 5,376,392, leaving a net book value of \$ 12,234,303. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total decrease in the Municipality's investment in capital assets for the current fiscal year was \$ 132,444 in terms of net book value. Depreciation charges for the year totaled \$ 672,995.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2003 the Municipality has \$4,538,661 of unexpended proceeds from bond issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged. See "Limitations on Ability of Municipalities to Issue General Obligation Debt-The Municipal Bonds" for a general description of such limitations.

The applicable law also requires that in order for a municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

CAPITAL ASSETS AND DEBT ADMINISTRATION (Continued)

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal years.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, 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.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Net Assets
June 30, 2003

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 2,209,102
Cash with fiscal agent	6,048,575
Accounts receivable:	
Municipal license tax	
Intergovernmental	930,583
Other	17,739
Capital assets	
Land, improvements, and construction in progress	1,825,177
Other capital assets, net of depreciation	10,409,126
Total capital assets	<u>12,234,303</u>
 Total assets	 <u>21,440,302</u>
 Liabilities	
Accounts payable and accrued liabilities	672,698
Due to other governmental entities	77,517
Deferred revenues:	
Municipal license tax	466,238
Federal grant revenues	294,710
Other	
Noncurrent liabilities:	
Due within one year	768,016
Due in more than one year	<u>8,554,236</u>
 Total liabilities	 <u>10,833,415</u>
 Net Assets	
Invested in capital assets, net of related debt	6,578,303
Restricted for:	
Capital projects	4,480,816
Debt service	1,318,315
Other Purposes	374,648
Unrestricted (deficit)	<u>(2,145,195)</u>
 Total net assets	 <u>\$ 10,606,887</u>

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Activities
For the Year Ended June 30, 2003

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 4,554,241	\$ -	\$ 61,653	\$ 24,871	\$ (4,467,717)
Public safety	63,574	913			(62,661)
Public works	2,725,523	23,745	196,147	63,716	(2,441,915)
Health and welfare	2,042,843	13,748	916,027		(1,113,068)
Culture and recreation	471,750	48,546	55,822		(367,382)
Economic development	231,477		192,771		(38,706)
Community development	322,485		260,621	30,000	(31,864)
Interest on long-term debt	117,257				(117,257)
Total governmental activities	\$ 10,529,150	\$ 86,952	\$ 1,683,041	\$ 118,587	(8,640,570)
General revenues:					
Property taxes					3,456,412
Municipal license tax					725,092
Other Local Taxes					456,059
Grants and contributions not restricted to specific programs					2,507,181
Interest and investment earnings					78,668
Miscellaneous					75,670
Total general revenues					7,299,082
Change in net assets					(1,341,488)
Net assets - beginning					11,948,375
Net assets - ending					\$ 10,606,887

Commonwealth of Puerto Rico
Municipality of Luquillo
Balance Sheet
Governmental Funds
June 30, 2003

	General Fund	Special Revenue Fund Federal Grants	Capital Project Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents	\$ 1,453,515	\$ 411,888	\$ -	\$ -	\$ 343,699	\$ 2,209,102
Cash with fiscal agent		133,363	4,538,661	1,318,315	58,236	6,048,575
Accounts receivable:						
Intergovernmental	329,925	563,095			37,563	930,583
Prepaid Expenses	17,739				-	17,739
Due from other funds	733,317				-	733,317
Total assets	\$ 2,534,496	\$ 1,108,346	\$ 4,538,661	\$ 1,318,315	\$ 439,498	\$ 9,939,316
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 469,684	\$ 170,504	\$ 26,377	\$ -	\$ 6,133	\$ 672,698
Due to other governmental entities	77,517					77,517
Due to other funds		506,254	31,468		195,595	733,317
Deferred revenues:						
Municipal license tax	466,238					466,238
Federal grant revenues		251,491			43,219	294,710
Other						-
Total liabilities	1,013,439	928,249	57,845	-	244,947	2,244,480
Fund balances:						
Reserved for:						
Encumbrances	306,965					306,965
Capital projects			4,480,816			4,480,816
Other purposes		180,097			194,551	374,648
Reserved reported in nonmajor funds:						
Debt service fund				1,318,315		1,318,315
Unreserved:						
Undesigned	1,214,092					1,214,092
Total fund balances	1,521,057	180,097	4,480,816	1,318,315	194,551	7,694,836
Total liabilities and fund balances	\$ 2,534,496	\$ 1,108,346	\$ 4,538,661	\$ 1,318,315	\$ 439,498	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	12,234,303
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	(9,322,252)
Net assets of governmental activities	\$ 10,606,887

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2003

	General Fund	Special Revenue Fund Federal Grants	Capital Project Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 2,990,915	\$ -	\$ -	\$ 465,497	\$ -	\$ 3,456,412
Municipal license taxes	725,092					725,092
Licenses, permits and other local taxes	467,423					467,423
Charges for services	41,388					41,388
Intergovernmental	2,568,834	14,697	93,716		271,917	2,949,164
Rent of property	33,287					33,287
Fines and forfeitures	913					913
Interest	78,668					78,668
Federal grants		837,769			438,220	1,275,989
Miscellaneous	74,310		37		60,108	134,455
Total revenues	6,980,830	852,466	93,753	465,497	770,245	9,162,791
Expenditures						
Current:						
General government	4,151,228		282,607		3,860	4,437,695
Public safety	127,223					127,223
Public works	1,712,274	492,155	327,884		110,049	2,642,362
Health and welfare	1,111,450	439,162			490,261	2,040,873
Culture and recreation	414,462		17,476		43,031	474,969
Economic development	35,136				196,197	231,333
Community development		260,621	51,125			311,746
Principal				325,000		325,000
Interest				117,257		117,257
Total expenditures	7,551,773	1,191,938	679,092	442,257	843,398	10,708,458
Excess (deficiency) of revenues over (under) expenditures	(570,943)	(339,472)	(585,339)	23,240	(73,153)	(1,545,667)
Other financing sources (uses)						
Transfers in				41,000		41,000
Transfers out	(41,000)					(41,000)
Long-term debt issued		521,000	4,430,000			4,951,000
Total other financing sources (uses)	(41,000)	521,000	4,430,000	41,000	-	4,951,000
Excess (deficiency) of revenues over expenditures and other financing sources (uses)	(611,943)	181,528	3,844,661	64,240	(73,153)	3,405,333
Fund balance, beginning	2,133,000	(1,431)	636,155	1,254,075	267,704	4,289,503
Fund balance, ending	\$ 1,521,057	\$ 180,097	\$ 4,480,816	\$ 1,318,315	\$ 194,551	\$ 7,694,836

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Luquillo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2003

Net Change in Fund Balances - Total Governmental Funds \$ 3,405,333

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 515,680

Depreciation expense on capital assets is reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. (672,995)

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in Governmental Funds. (131,871)

Some revenues reported in the Statements of Activities do not provide current financial resources in Governmental Funds. 143,494

Some expenses reported in the Governmental Funds require the use of current financial resources and, therefore, are not reported as expenditures in Statement of Activities. 24,871

The issuance of long-term debt provides current financial resources to Governmental Funds, while the repayment of principal of long-term debt consumes current financial resources. This is the amount by which debt proceeds exceed debt service principal payments. (4,626,000)

Change in Net Assets of Governmental Activities \$ (1,341,488)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Luquillo** (the Municipality) was founded on the year 1797. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. With this financial report, the Municipality has changed its financial reporting to comply with the provisions of GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. As part of the implementation of GASB Statement No. 34, the Municipality adopted a prospective reporting of its general infrastructure assets. This result in the recognition of the costs incurred during the fiscal year ended June 30, 2003 for the acquisition of infrastructure assets (e.g., roads, bridges, sidewalks). The Municipality expects to report the retroactive historical costs of all of its infrastructure assets during the fiscal year beginning on July 1, 2003.

In conjunction with the implementation of GASB Statement No. 34, the Municipality has also implemented paragraphs six to eleven of GASB Statement No. 38, Certain Financial Statements Note Disclosures, which rescinds some and modifies other financial statement disclosure requirements. As part of the implementation of Statement No. 34, the Municipality revised the classification of its funds. Accordingly, beginning fund balances were restated as explained in Note 12.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Component Units

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 are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are 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.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund - Federal Grants- is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Project Fund - Local, State and Federal Grants - is the accounting entity in which revenues derived from local funds, state and federal grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund- General Fund is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund - Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund – Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Funds- Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

Capital Projects Funds – Local, State and Federal Grants - Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

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 are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, rent, 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. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue 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. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. 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, then unrestricted resources, as they are needed.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The preparation of the 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

- 1. Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services 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.

- 2. 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."

Advances between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent mostly contributions from the Puerto Rico Electric Power Authority, which contribute a specific percentage of their revenues as payment in lieu of taxes. Intergovernmental receivable in the special revenue fund represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

6. **Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

7. **Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The municipality has the following reservations of fund balance:
 - a. **Capital Projects-** Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
 - b. **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.
 - c. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
 - d. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
 - a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
10. **Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2003 amounted to approximately \$230,765. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$135,011 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$12,234,303	
Deduct:		
Bonds Payable	(4,835,000)	
Notes Payable	(821,000)	6,578,303
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		4,480,816
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service		1,318,315
<u>Net assets restricted for other purposes</u>		
Other governmental funds - fund balance restricted for other purposes		\$374,648
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$1,521,057	
Deduct:		
Bond and Notes	(1,420,000)	
Compensated absences debt	(733,373)	
Social Security - Treasury Department	(107,955)	
Property Tax - Treasury Department	(6,648)	
Property Tax - CRIM Law 42	(533,459)	
Property Tax - CRIM Law 146	(700,940)	
Property Tax - CRIM Liquidation 2001-2002	<u>(163,877)</u>	<u>(2,145,195)</u>
Total net assets - governmental activities		<u>\$10,606,887</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

2. 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 balances in commercial banks of approximately \$1,453,515 and \$411,888, in the general fund and special revenue fund – federal grants, respectively, were fully collateralized at June 30, 2003. In the other governmental funds there were deposits with commercial banks of approximately \$343,699, respectively, that were fully collateralized.

The deposits at GDB of approximately the \$133,363 in the special revenue fund – federal grant, \$4,538,661, that is restricted principally for capital projects in the capital project fund – local, state and federal grants, the \$1,318,315 in the debt service fund, , and the \$58,236 that is restricted for other purposes in the other governmental funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 24 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2003, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 24. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2003, net of allowance for uncollectibles.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

3. RECEIVABLES (CONTINUED)

B. *Intergovernmental Receivables*- Intergovernmental receivables in the general fund principally consist of the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from the revenues the Municipality is entitled to receive in lieu of payment of taxes, and the amounts due from the Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico resulting from the excess of current year property tax collections over current year advances. The amounts receivable from governmental entities are as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$329,925
Total	<u>\$329,925</u>

Intergovernmental receivable in special revenue funds represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$42,095
Community Facilities Loan	<u>521,000</u>
Total	<u>\$563,095</u>

Intergovernmental receivable in other governmental funds represents expenditures incurred not yet reimbursed by the state and local government. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Department of Labor	<u>\$37,563</u>
Total	<u>\$37,563</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2003, and interfund transfers during the fiscal year ended at June 30, 2003, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund – Federal Grants	Payroll and related accruals paid and not reimbursed by the Federal Programs	\$506,254
General Fund	Capital Project Fund – State and Local Grants	Payroll and related accruals paid and not reimbursed by the Capital Project Funds	31,468
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed by Other Governmental Funds	<u>195,595</u>
Total			<u>\$733,317</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$41,000
Total			<u>\$41,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2003, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2002</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2003</u>
Capital asset, not being depreciated:				
Land	\$1,800,306	\$24,871		\$1,825,177
Construction in progress	_____	_____	\$ -	_____
Total capital assets not being depreciated	<u>1,800,306</u>	<u>24,871</u>	-	<u>1,825,177</u>
Capital assets, being depreciated:				
Buildings	\$11,355,667			\$11,355,667
Buildings improvements	81,603	206,515		288,118
Infrastructure		8,292		8,292
Infrastructure improvements		96,023		96,023
Equipment	1,433,750	57,217		1,490,967
Furnishing	495,837	447		496,284
Work of art	400			400
Computers	134,550	12,887		147,437
Vehicles	<u>1,768,031</u>	<u>134,299</u>	-	<u>1,902,330</u>
Total capital assets being depreciated	<u>\$15,269,838</u>	<u>\$515,680</u>	-	<u>\$15,785,518</u>
Less accumulated depreciation for:				
Buildings	(\$1,673,614)	(\$283,892)		(\$1,957,506)
Buildings improvements	(11,304)	(3,902)		(15,206)
Infrastructure		(559)		(559)
Infrastructure improvements		(864)		(864)
Equipment	(1,100,669)	(155,140)		(1,255,809)
Furnishing	(282,091)	(72,353)		(354,444)
Works of art	(3)	(40)		(43)
Computers	(107,342)	(21,272)		(128,614)
Vehicles	<u>(1,528,374)</u>	<u>(134,973)</u>	-	<u>(1,663,347)</u>
Total accumulated depreciation	<u>(\$4,703,397)</u>	<u>(\$672,995)</u>	-	<u>(\$5,376,392)</u>
Total capital assets being depreciated, net	<u>\$10,566,441</u>	<u>(157,315)</u>	-	<u>\$10,409,126</u>
Governmental activities capital assets, net	<u>\$12,366,747</u>	<u>(\$132,444)</u>	-	<u>\$12,234,303</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

5. CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to functions/programs of the Municipality as follows:

Governmental activities:

General government	\$368,677
Public safety	13,625
Public works	139,702
Culture and recreation	74,090
Health and welfare	66,018
Community development	10,739
Economic development	<u>144</u>

Total depreciation expense-governmental activities **\$672,995**

6. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

6. PROPERTY TAXES (CONTINUED)

On December 31, 1992 the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2003, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$6,648 and is payable as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2004	<u>\$6,648</u>
Total	<u>\$6,648</u>

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money. A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

6. PROPERTY TAXES (CONTINUED)

The government-wide statement of net assets includes an outstanding balance of \$700,940, 163,877 and 533,459 related to Law 146, 2001-2002 CRIM final liquidation and Law 42.

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 Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$ 50,000 of the assessed value to retailers having annual net sales of less than \$ 150,000.

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of approximately \$466,238 in the general fund relates to municipal license tax collected in fiscal year 2002-03 that will be earned in fiscal year 2003-04.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

7. DEFERRED REVENUES (CONTINUED)

B. Federal Government- The deferred revenues presented in other governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Rental Voucher Program	\$43,218
Incentive Grant – Department of Transportation	27,897
Emergency Management Performance Grant	116,402
Emergency Management Act	12,871
Housing Preservation Grant	718
Nutrition Program for the Elderly	8,636
Community Development Block Grant	5,233
Title V – Delinquency Prevention Program	930
Special Program for Aging Title III	22,163
Community Service Block Grant	1,870
Child Care Block Grant	50,412
Hazard Mitigation Grant	<u>4,360</u>
Total	<u>\$294,710</u>

8. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2003, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$1,970,000	\$4,430,000	\$145,000	\$6,255,000	\$230,000
Notes Payable	480,000	521,000	180,000	821,000	264,000
Property Tax Advance – Treasury Department	7,598		950	6,648	950
Social Security – Treasury Department	143,955		36,000	107,955	36,000
CRIM – Property Tax- Law 146	700,940			700,940	
CRIM – Property Tax- Liquidation 2001-2002	163,877			163,877	163,877
CRIM – Property Tax- Law 42	576,023		42,564	533,459	42,560
Compensated Absences	637,982	131,871	36,480	733,373	30,629
Claims and judgments	<u>27,500</u>		<u>27,500</u>		
Total	<u>\$4,707,875</u>	<u>\$5,082,871</u>	<u>\$468,494</u>	<u>\$9,322,252</u>	<u>\$768,016</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

8. LONG-TERM LIABILITIES (CONTINUED)

1. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.
2. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality issued bonds for approximately \$4,430,000. Bonds payable outstanding at June 30, 2003 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2003</u>
1985 Series	7-1-04	\$ 319,000	8.00 %	\$ 40,000
1993 Series	7-1-12	2,015,000	5.00% to 8.00%	1,380,000
2000 Series	7-1-14	460,000	2.70% to 7.81%	405,000
2003 Series	7-1-27	4,430,000	5.00% to 6.50%	4,430,000
Total general obligation bonds				<u>\$6,255,000</u>

These bonds, except the 1985 Series bond, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 230,000	\$ 288,338
2005	210,000	394,340
2006	220,000	379,667
2007	235,000	364,017
2008	255,000	347,072
2009-2013	1,595,000	1,428,592
2014-2018	895,000	990,959
2019-2023	1,105,000	679,413
2024-2028	<u>1,510,000</u>	<u>258,375</u>
Total	<u>\$6,255,000</u>	<u>\$5,130,773</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

8. LONG-TERM LIABILITIES (CONTINUED)

- 3. Notes Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2003</u>
1993 Series	7-1-03	525,000	4.87% to 6.71%	\$ 110,000
2000 Series	7-1-04	425,000	2.70% to 7.81%	190,000
2003 Series	1-1-10	521,000	4.75%	521,000
Total notes payable				<u>\$821,000</u>

The notes are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 264,000	\$ 11,819
2005	168,000	23,108
2006	71,000	18,478
2007	74,000	15,105
2008	78,000	11,590
2009-2013	166,000	11,922
2014-2018		
2024-2028		
Total	<u>\$821,000</u>	<u>\$92,022</u>

- 4. Property Tax Debt-** These amounts represent the balance owned to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2003, as described in Note 6, from property tax advances in excess of actual collections and other property tax debts.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

8. LONG-TERM LIABILITIES (CONTINUED)

- 5. Compensated absences-** The government-wide statement of net assets includes approximately \$398,309 of accrued sick leave benefits, and approximately \$335,064 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

9. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

9. PENSION PLAN (CONTINUED)

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2003 amounted to approximately \$192,872 and \$216,180, respectively.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation 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 1, 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. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up 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 a 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.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2003, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

10. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department 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.

11. CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

12. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$251,694 to properly present the previously reported fund balance at June 30, 2002. The restatement is mainly due to the reclassification of beginning cash balances.

The beginning Fund Balance for Special Revenue has been restated by approximately \$392,146 to properly presents the previously reported fund balance at June 30, 2002. The restatement is mainly due to the reclassification of beginning cash balances.

The beginning Fund Balances for Debt Service Fund has been restated by approximately \$480,663 to properly present the previously reported fund balances at June 30, 2002. The restatement is mainly due to the recognition of the amount due to CRIM related to Final Liquidation 2001-2002.

The beginning Fund Balances for Capital Projects Funds has been restated by approximately \$127,254 to properly present the previously reported fund balances at June 30, 2002. The restatement is mainly due to the reclassification of beginning cash balances.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2003

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u> (Budgetary Basis) (See Note 1)	<u>Variance with</u> <u>Final Budget</u> <u>Positive</u> <u>(Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES AND OTHER FINANCING SOURCES:				
Property taxes	\$2,720,455	\$2,720,455	\$2,480,053	(\$240,402)
Municipal license tax	591,850	712,203	725,092	12,889
Licenses, permits and other local taxes	356,000	426,504	467,423	40,919
Charges for service	57,780	38,756	41,388	2,632
Intergovernmental	2,532,896	2,538,612	2,568,834	30,222
Rent of property	24,720	27,045	33,287	6,242
Fines and forfeitures	1,100	865	913	48
Interest	30,000	45,810	78,668	32,858
Miscellaneous	126,500	148,252	255,247	106,995
Operating transfer from other fund	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total revenues and other financing sources before carryover	<u>6,441,301</u>	<u>6,658,502</u>	<u>6,650,905</u>	<u>(7,597)</u>
Budget carryover (1)		600,094	600,094	
Total revenues and other financing sources after carryover	<u>6,441,301</u>	<u>7,258,596</u>	<u>7,250,999</u>	<u>(7,597)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	3,405,194	3,937,046	3,922,961	14,085
Public safety	105,475	107,863	102,675	5,188
Public works	1,452,008	1,605,910	1,561,621	44,289
Health and welfare	1,085,987	1,101,886	1,086,678	15,208
Culture and recreation	310,810	427,520	412,273	15,247
Economic development	40,827	37,371	34,576	2,795
Community development				
Urban development				
Education				
Operating transfer to other fund	<u>41,000</u>	<u>41,000</u>	<u>41,000</u>	<u> </u>
Total expenditures, encumbrances and other financing uses	<u>6,441,301</u>	<u>7,258,596</u>	<u>7,161,784</u>	<u>96,812</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>-</u>	<u>89,215</u>	<u>89,215</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$7,250,999
Differences-budget to GAAP:				
Budget Carryover				(600,094)
Account Receivable from CRIM at June 30, 2003				<u>329,925</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$6,980,830</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$7,161,784
Differences-budget to GAAP:				
Payments of prior year accounts payable recorded as expenditures for GAAP basis				(69,491)
Prior year encumbrances recorded as current year expenditures for GAAP basis				671,934
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(171,454)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$7,592,773</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2003

1. 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 fund.

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.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2003 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2003.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2003

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Program:			
Nutrition Program for the Elderly	10.570		\$ 36,755
Direct Program:			
Community Facilities Loans and Grants	10.766		340,903
			377,658
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Section 8 Housing Choice Vouchers	14.871		438,220
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants - State's Program	14.228	02-AB, FC-41 01-FD-41 00-FD-41 99-FD-41 98-FD-41 94-FD-41	260,621
			698,841
U.S FEDERAL EMERGENCY MANAGEMENT AGENCY:			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Public Assistance Grants	83.544	1247-DRPR	132,273

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency: Emergency Management Performance Grants	83.552	Not Available	<u>4,282</u>
Total U.S. Federal Emergency Management Agency			<u>136,555</u>
U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico Governor's Office (Elderly Office): Special Programs for Aging - Title III, Part B - Grant for Supportive Services and Senior Centers	93.044	Not Available	131,114
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families: Child Care and Development Block Grant	93.575	Not Available	<u>271,293</u>
Total U.S. Department of Health and Human Services			<u>402,407</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 1,615,461</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2003

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Luquillo and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund Federal Grants and in the Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Description	Special Revenue Fund Federal Grants	Other Governmental Funds	Total
Per Schedule of Expenditures of Federal Awards	\$ 1,177,241	\$ 438,220	\$ 1,615,461
Non federal programs expenditures	14,697	405,178	419,875
Total expenditures in the general purpose financial Statements	<u>\$ 1,191,938</u>	<u>\$ 843,398</u>	<u>\$ 2,035,336</u>



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

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

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

We have audited the basic financial statements of the **Municipality of Luquillo** as of and for the year ended June 30, 2003, and have issued our report thereon dated December 18, 2003, which was unqualified. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the **Municipality of Luquillo's** basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Luquillo's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Luquillo's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items 03-01 through 03-03.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the Municipality of Luquillo in a separate letter dated December 18, 2003.

This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 18, 2003

Stamp No. 1942309 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

**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 the Municipal Legislature
Municipality of Luquillo
Luquillo, Puerto Rico**

Compliance

We have audited the compliance of the **Municipality of Luquillo** 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, 2003. The **Municipality of Luquillo's** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Luquillo's** management. Our responsibility is to express an opinion on the **Municipality of Luquillo'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 the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality of Luquillo's** compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the **Municipality of Luquillo's** compliance with those requirements.

As described in items 03-05 through 03-09 in the accompanying schedule of findings and questioned costs, the **Municipality of Luquillo** did not comply with requirements regarding Eligibility for Individuals, Cash Management and Special Test that are applicable to its Section 8 Housing Choice Voucher Program. Compliance with such requirements is necessary, in our opinion, for the **Municipality of Luquillo** to comply with requirements applicable to that program.

**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
(CONTINUED)**

In our opinion, except for the noncompliance described in the preceding paragraph, the **Municipality of Luquillo** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, 03-04 and 03-10 through 03-12.

Internal Control Over Compliance

The management of the **Municipality of Luquillo** is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality of Luquillo'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 the **Municipality of Luquillo's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 03-04 through 03-12.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on 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 material weakness. However, of the reportable conditions described above, we consider items 03-05 through 03-09 and 03-11 to be material weaknesses. We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Luquillo** in a separate letter dated March 12, 2004.



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
(CONTINUED)

This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 12, 2004

Stamp No. 1942310 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2003

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness identified?	Yes	No X
Reportable conditions identified not considered to be material weaknesses?	Yes X	None reported
Noncompliance material to financial statements noted?	Yes	No X

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes X	No
Reportable conditions identified not considered to be material weaknesses?	Yes X	None reported
Type of auditors’ report issued on compliance for major programs:	Unqualified, except Qualified for Section 8 Housing Choice Voucher (CFDA No. 14.871)	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes X	No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
10.766	Community Facilities Loans and Grants
14.228	Community Development Block Grant – State’s Program
14.871	Section 8 Housing Choice Voucher

Dollar threshold used to distinguish between Type A and Type B programs	\$300,000
Auditee qualified as low-risk auditee?	Yes No X

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section II – Financial Statements Findings

Finding Reference	03-01
Requirement	Financial Reporting – Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds).
Criteria	Chapter VIII, Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.
Cause of Condition	The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.
Effect of Condition	The Municipality's accounting system did not provide updated and complete financial information that present the financial position, the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend that the Municipality should implement the necessary internal controls and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, expenditures, interfund transactions, etc.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section II - Financial Statements Findings

Finding Reference	03-02
Requirement	Cash Receipts\Revenue, Receivable - Collections
Statement of Condition	We performed a cash receipt test and examined a sample of sixty (60) cash collections and noted that for twenty four (24) collections, the Municipality's Revenue Collection Office did not maintain the evidence of the customer's remittance data and other support. However, the evidence was available in the Municipality's Department that generated such revenue.
Criteria	The Revised Regulation on Basic Standards for Municipalities of Puerto Rico, Chapter III, Section V, establish that the Finance Director or any other designed public official are responsible for the maintenance and conservation of the records, documents and files related to the revenues transactions.
Cause of Condition	The Municipality's controls and procedures failed to assure that all revenues were properly documented.
Effect of Condition	The Municipality is not compliance with regulations stated in The Revised Regulation on Basic Standards for Municipalities of Puerto Rico, Chapter III, Section V.
Recommendation	The Municipality should strengthen the filing procedures in order to assure that collections supporting documents as deposit slips, treasurer receipts and the customer's remittance data and other support are duly organized and filled in the Municipality's Revenue Collection Office.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section II – Financial Statements Findings

Finding Reference **03-03**

Requirement **Payroll and Related Liabilities – Payroll Preparation and Timekeeping**

Statement of Condition We performed a payroll test and examined a sample of sixty (60) personnel files, and the related payroll documents of these employees for the semi-monthly payroll ended June 30, 2003. The following will summarize the situations noted:

- a. For five (5) employees, we noted difference between the employee assistance cards and the employee accumulative vacations card.
- b. For three (3) employees, the salary stated in the employee file did not agree with the salary included in the payroll for the period ended June 30, 2003.
- c. For one (1) employee the position stated in the employee file did not agree with the position included in the payroll for the period ended June 30, 2003.
- d. For four (4) employees we noted that the regular vacation per accumulative vacations card does not agree with the regular vacations per Accrued Compensated Absence Detail prepared by the Municipality.
- e. For three (3) employees we noted that the sick vacation per accumulative vacations card does not agree with the sick vacations per Accrued Compensated Absence Detail prepared by the Municipality.
- f. One (1) employee file was not available for our examination.

Criteria

The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico, Chapter IV, Section 18-(1) establish that the Municipality will prepare the payroll based on the employee files. Also, Article 11.023 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated employee files.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section II - Financial Statements Findings

Finding Reference	03-03 (continued)
Cause of Condition	The Municipality's procedures and controls failed to assure the proper preparation and payment of payroll, the exactitude of accumulative vacation and sickness balances and the maintenance of updated employee's file.
Effect of Condition	The Municipality did not maintain an adequate control over the personnel files, compensated absences records, and time and assistance records.
Recommendation	We recommend the Municipality to strengthen its procedure to assure that the Human Resource Department pay the correct salaries as stated on the employees files. We also recommend that the Municipality should review all payrolls prepared and the Human Resources Department should deduct from the accumulative vacation worksheet the vacation and sick days used by employees as detailed in the time assistance card.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-04
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Activities Allowed or Unallowed
Statement of Condition	We selected for examination a sample of fifteen (15) participant's files and noted that at June 30, 2003 in five (5) files the PHA did not actualize the contracts with the owner to make Housing Assistance Payments on behalf of the family.
Criteria	The Code of Federal Regulations 24, Subpart A, Section 982.1 (a)(2) states that if the PHA approves a family's unit and determines that the rent is reasonable, the PHA must contract with the owner to make Housing Assistance Payments on behalf of the family.
Cause of Condition	The PHA controls and procedures failed to assure that the contracts with the owners to make Housing Assistance Payments on behalf of the family, were properly actualized.
Effect of Condition	The PHA is not in compliance with the Code of Federal Regulations 24, Subpart A, Section 982.1 (a)(2).
Recommendation	We recommend that the PHA should strengthen its procedures in order to assure that the contracts were actualized and prepared every time the PHA approves a family's unit.
Questioned Costs	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-05
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Eligibility of Individuals
Statement of Condition	<p>We performed an eligibility test and examined fifteen (15) participant's files. The following summarizes the situations found:</p> <ul style="list-style-type: none">a. In four (4) participant's files there is no evidence that the head of household signed a release form, to allow the PHA to obtain information from third parties.b. In six (6) participant's files, there is no evidence that members of the family with 18 years or more signed a release form, to allow the PHA to obtain information from third parties.c. In ten (10) participant's files, there is no evidence of the "Privacy Act Notice" signed by the head of household and by any other member of the family with 18 years or older.d. Five (5) participant's files did not have complete evidence to support family annual income, and to support if the utilities were paid by the owner or by the tenant.
Criteria	<p>Code of Federal Regulations 24, Sections 5.230, 5,212 and 982.516 states that as a condition of admission or continued occupancy, the PHA must require the tenant and other family members to provide necessary information, documentation and releases for the PHA to verify income eligibility. As part of this regulation the participant and other members of the family who are at least 18 years old must sign an application form, one or more releases forms, a federally prescribed general release form for employment information and a Privacy Act Notice.</p>
Cause of Condition	<p>The PHA internal control and procedures failed to assure that the participant's files include all required documentation and releases required by federal agencies as condition of admission or continued occupancy.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-05 (continued)
Effect of Condition	Participant's files examined not include all documentation required by the Federal Agency.
Recommendation	The PHA must give instructions to the program staff to assure that the participant's files include all documentation required by the Federal Agency.
Questioned Costs	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-06
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Eligibility of Individuals
Statement of Condition	<p>During our verification of fifteen (15) participant's files we noted the following exceptions related to the Housing Assistance Payment calculations:</p> <ul style="list-style-type: none">a. In seven (7) participant's files the program used an incorrect utility allowance amount in the Housing Assistance Payment calculation.b. In eight (8) participant's files the program as, part of the Housing Assistance Payment calculation, did not used the lower of the "Payment Standard for the Family" or the "Gross Rent of the Unit".c. On ten (10) participant's files the Housing Assistance payment was incorrectly determined. As result, the program paid an incorrect Housing Assistance Payment to the owner and it cause differences in the amount of Tenant Rent to owner or the utility reimbursement to the family.d. In one (1) participant's file the final Housing Assistance Payment calculation reflect a HAP to owner of \$393 and a Tenant Rent to Owner of \$220. Those amount represents an over payment of \$56 because the rent to owner was only \$557.e. In one (1) participant's file the PHA did not reexamine a family income and composition reexamination during the fiscal year 2002-2003.
Criteria	<p>Code of Federal Regulations 24, Subpart K, Section 982.505 establish the procedures to be followed in order to calculate the Housing Assistance Payment. The Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6) establishes procedures for the HAP calculation. Also, the Code of Federal Regulations 24, Subpart K, Section 982.516, requires the PHA to reexamine family income and composition at least once every twelve months and adjust the tenant rent and housing assistance payment as necessary.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-06 (continued)
Cause of Condition	The PHA controls and procedures failed to assure that all HAP's payments are duly computed by the program staff and to assure that the PHA reexamine family income and composition at least every twelve months.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Section 982.505 and 982.516 and with the Housing Choice Voucher Guidebook, number 7420.10G, Chapter six (6).
Recommendation	We recommend the PHA to strengthen its monitoring procedures to assure the Housing Assistance Payments are duly computed as required by the Federal Regulations. Also, we recommend the PHA to strengthen its monitoring procedures to assure that a reexamination of family income and composition will be made at least once every twelve months and will adjust the tenant rent and housing assistance payment as necessary.
Questioned Costs	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-07
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	<p>We realized Cash Management Test and after our procedures we found that the PHA maintained during the current fiscal year average cash balance in books of approximately \$45,974. At June 30, 2003, the cash balance in book was \$64,958; \$23,959 of these funds was from HUD overpayment during the fiscal year 2002-2003 as determined in the year-end settlement; \$4,236 was from operating reserve at June 30, 2003, as determined in the year-end settlement; and the remaining \$36,763 we could not determine its origin.</p> <p>Also, we noted that during seven months of the fiscal year 2002-2003 the PHA maintained a leasing rate under 95%, and maintained an average leasing rate of 94% for the fiscal year. The PHA did not submit to HUD a revised requisition (Form 52663) to reduce the monthly advances.</p>
Criteria	<p>OMB Common Rules, Subpart C, Section 85.20 (b) (7), requires a cash management system; in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee.</p>
Cause of Condition	<p>The PHA did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.</p>
Effect of Condition	<p>The PHA did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-07 (continued)
Requirement	Cash Management
Recommendation	We recommend that management should strengthen it's procedures to minimize the time elapsed between the transfer of funds from the federal agency and the disbursements made by the PHA. The management must submit a revised requisition (Form 52663) to HUD when the leasing rate not exceeds the 95% in order to avoid an excessive adjusted cash balance in books.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-08
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Selection from the Section 8 Waiting List
Statement of Condition	During our test we noted that the PHA did not maintained a waiting list during the fiscal year 2002-2003.
Criteria	Code of Federal Regulations 24, Subpart E, Section 982.201 through 982.207 states the waiting list procedures. The PHA must have written policies in its Housing Choice Voucher Program administrative plan for selecting applicants from the waiting list and PHA documentation must show that the PHA follows these policies when selecting applicants for admission form the waiting list. Except for special admission applicants, all families admitted to the program must be selected from the waiting list. Selection from the waiting list generally occurs when the PHA notifies a family whose name reaches the top of the waiting list to come in to verify eligibility for admission.
Cause of Condition	The PHA did not perform adequate monitoring procedures to assure the existence and maintenance of a waiting list and to assure that participants were selected from the top of the waiting list.
Effect of Condition	The PHA is no in compliance with Code of Federal Regulations 24, Subpart E, Sections, 982.201 through 982.207.
Recommendation	We recommend to the PHA to create a waiting list that contains all requirements of the federal regulations. Also, we recommend management to create and maintain a clear set of participant selection procedures to assure that except for the special admissions, all families admitted to the program must be selected from the waiting list.
Questioned Costs	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-09
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Utility Allowance Schedule
Statement of Condition	The PHA did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2003. The PHA did not perform a review of the utility rates during the fiscal year to ascertain if there has been a change of ten percent or more in a utility rate.
Criteria	Code of Federal Regulations 24, Subpart K, Section 982.517 states that the PHA must maintain an up-to-date utility allowance schedule. The PHA must review utility rate data for each utility category each year and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
Cause of Condition	The PHA used the Utility Allowance Schedules published by the federal government.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Section 982.517.
Recommendation	The PHA should evaluate utility allowance rate each year as established in the federal regulations and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category.
Questioned Costs	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-10
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test - Housing Quality Standards Enforcement
Statement of Condition	During our examination of fifteen (15) participant's files we noted that the evidence and documents included on three (3) participant's files did not show clearly if the PHA followed up the deficiencies noted on the Housing Quality Standards Inspection before the expiration of the correction period.
Criteria	Code of Federal Regulations 24, Subpart I, Section 982.404 establish that for units under contract that fail to meet HQS, the PHA must require the owner to correct any cited life threatening HQS deficiencies within 24 hours after the inspections and all other HQS deficiencies within 30 calendar days or within a specified PHA-approved extensions. If the owner does not correct the cited HQS deficiencies within the specified correction period the PHA must stop the Housing Assistance Payment or must terminate the HAP contract. Also, for family-cause defects, if the family does not correct the cited HQS deficiencies within the specified correction period, the PHA must take prompt and vigorous action to enforce the family obligations.
Cause of Condition	The controls and procedures failed to assure that the PHA properly follow up the deficiencies noted as part of the Housing Quality Standards inspections within the specified time frame.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart I, Section 982.404.
Recommendation	We recommend management to improve monitoring procedures to assure that the deficiencies noted as part of its HQS inspections were corrected within the specified time frame and to assure that the PHA follow up procedures were properly documented in the tenant file.
Questioned Costs	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-11
Program	Community Development Block Grants - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico - Office of Commissioner of Municipal Affairs
Requirement	Allowable Cost - Cost Principles
Statement of Condition	<p>During our disbursement test of the Community Development Block Grant - State's Program we noted the following situations:</p> <ul style="list-style-type: none">a. Twelve (12) disbursement vouchers were not cancelled or marked as paid along the document.b. Four (4) disbursement vouchers the disbursement voucher did not include evidence of the Purchase Requisition.c. On one (1) disbursement voucher did not have evidence of the receiving report or the certification of the Municipality's employee who receive the goods or services.d. On eleven (11) disbursement vouchers the purchase orders were prepared after the receiving of the goods or services.
Criteria	<p>Code of Federal Regulations 24, Subpart I, Part 570.489 (d) states that the sub-grantee shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirements must be available for Federal inspection and must: (i) be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) ensure that funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments. The sub-grantee may satisfy this requirement by: (i) using fiscal and administrative requirements applicable to the use of its own funds; (ii) adopting new fiscal and administrative requirements; or (iii) applying the provisions in 24 CFR part 85 "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments."</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-11 (continued)
Cause of Condition	Municipality controls and procedures failed to assure that all disbursements made have all the necessary supporting documents and were realized for allowable costs. Also, the Municipality's record retention system failed to assure that all documents related to the federal grants were properly maintained.
Effect of Condition	Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Part 570.489 (d).
Recommendation	We recommend that the Municipality should strength its procedures to assure that all disbursements vouchers contain all supporting documents and approval signatures should be obtained before the related payments are made. The Municipality should prepare a purchase order before the receipt of any good or service. Also, the Municipality's should strength its record retention system to assure that all documents related to federal grants were properly maintained.
Questioned Cost	None.
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **03-12**

Program **Community Development Block Grants - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico - Office of Commissioner of Municipal Affairs**

Requirement **Reporting**

Statement of Condition **During our examination of reporting we verified the Financial Quarterly Report ended on June 30, 2003. The following summarize the differences between the amounts presented in the Financial Quarterly Report and the amounts presented in the program's General Ledger:**

Cash Receipts Accounting Number	Amount per Quarterly Report	Amount per General Ledger	Difference
01-FD-ADM	\$ 57,090.44	\$ 58,568.42	(\$ 1,477.98)
00-FD-ADM	142,277.05	142,288.35	(11.30)
99-FD-ADM	162,032.97	162,348.97	(316.00)
98-FD-ADM	130,475.17	131,675.17	(1,200.00)
98-FD-003	128,346.63	128,546.03	(199.40)
98-FC-001	73,853.67	74,303.67	(450.00)

Cash Disbursements Accounting Number	Amount per Quarterly Report	Amount per General Ledger	Difference
01-FD-ADM (709)	\$ 962.85	\$ 987.85	(\$ 25.00)
00-FD-ADM (706)	2,991.77	3,100.52	(108.75)
00-FD-ADM (707)	9,659.51	9,953.16	(293.65)
00-FD-ADM (709)	1,874.30	2,087.60	(213.30)
00-FD-006 (505)	60,500.00	60,150.00	350.00
99-FD-ADM (703)	2,512.13	3,011.68	(499.55)
99-FD-ADM (713)	2,683.92	2,359.69	324.23
99-FD-005 (601)	83,952.25	83,498.30	453.95
99-FD-005 (602)	14,465.34	14,651.02	(185.68)
94-FD-ADM (702)	3,459.46	2,467.56	991.90
94-AF-ADM (707)	3,000.00	3,154.85	(154.85)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	03-12 (continued)
Criteria	Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirement must be available for Federal inspection and must: (i) be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) ensure that the funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments.
Cause of Condition	The Municipality financial management system failed to ensure accurate, current, and complete disclosure of the financial results of financially assisted activities.
Effect of Condition	The Municipality did not report accurate financial results to pass-through grantor for the quarter ended June 30, 2003.
Recommendation	We recommend to the Municipality Management to reconcile differences between the financial quarterly report and the general ledgers before report submission to the pass-through grantor.
Questioned Costs	None
Management Response	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2003

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
02-04	14.228	<p><u>The Municipality should strengthen its procedures to assure that all disbursements vouchers contain all supporting documents and approval signatures before the related payments are made.</u></p> <p>Related with the \$15,000 Questioned Costs, full corrective action has been taken.</p> <p>Related with the internal controls weakness, no corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-11.</p>
02-05	14.228	<p><u>The Municipality should follow monitoring system procedures developed, including obtaining contractor's and subcontractor's weekly payrolls to be reviewed on a weekly basis by the responsible municipal employee, and interview contractor's and subcontractor's laborers periodically (up to ten percent (10%) of the workers on long term projects) to establish the degree of compliance and the nature and extend of violations, if any.</u></p> <p>Full corrective action has been taken.</p>
02-06	14.228	<p><u>We recommend that the Municipality should implement procedures in order to assure the proper valuation and timeliness of recognition of real and personal property as well as Construction in Progress in the Property Subsidiary Ledger in a manner that it provides updated and complete financial information.</u></p> <p>Full corrective action has been taken.</p>
02-07	14.228	<p><u>The Municipality should improve its procedures to assure that proposals should be requested for the acquisition of professional services.</u></p> <p>Full corrective action has been taken.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
02-08	14.228	<p><u>The Municipality should implement procedures in order to assure that all financial and programmatic reports are submitted on time to the agencies and prepared in accordance with the required accounting basis.</u></p> <p>Full corrective action has been taken.</p>
02-09	14.871	<p><u>The Municipality should implement controls and procedures in order to assure the accountability of all financial transactions as required by the federal regulations.</u></p> <p>Full corrective action has been taken</p>
02-10	14.871	<p><u>The Municipality should strength its procedures to assure that all disbursements vouchers contain all supporting documents and approval signatures before the related payments are made.</u></p> <p>Full corrective action has been taken.</p>
02-11	14.871	<p><u>The Municipality should implement and design procedures in order to assure that the documents and records were properly maintained. Also, the Municipality should strength its procedures in order to assure that the contracts were actualized and prepared every time the PHA approves a family's unit.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-04.</p>
02-12	14.871	<p><u>The Program should establish monitoring procedures to assure that the participant's files include all documentation required by federal agencies.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-05.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
02-13	14.871	<p><u>The Municipality should perform monitoring procedures to assure the HAPs are duly computed as required by the Federal Regulations. Also, the Municipality should perform monitoring procedures to assure that a reexamination of family income and composition will be made at least once every twelve months and will adjust the tenant rent and housing assistance payment as necessary.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-06.</p>
02-14	14.871	<p><u>The Municipality should implement controls and procedures in order to assure accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports. Also, the Municipality should implement procedures in order to assure that all financial and programmatic reports are submitted on time to the agencies and are prepared in accordance with the required accounting basis.</u></p> <p>Full corrective action has been taken.</p>
02-15	14.871	<p><u>The Municipality should improve its internal controls and monitoring procedures to assure that the program complies with federal regulations</u></p> <p>Full corrective action has been taken.</p>
02-16	14.871	<p><u>The Municipality should strengthen it's procedures in order to assure that the form HUD-50058, Family Report, was submitted electronically to HUD each time the PHA completes an admission, annual reexamination, interim reexamination, portability move-in, portability move-out, and when a family end participation in the program.</u></p> <p>Full corrective action has been taken.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
02-17	14.871	<p><u>The Municipality should create a waiting list that contains all requirements of the federal regulations, and also, create and maintain a clear set of participant selection procedures to assure that except for the special admissions, all families admitted to the program must be selected from the waiting list.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-08.</p>
02-18	14.871	<p><u>The Federal Program Department must establish adequate controls to assure that the rent paid to the owners was reasonable and that appropriate documentation of the determination of reasonable rent is maintained in participant's files.</u></p> <p>Full corrective action has been taken.</p>
02-19	14.871	<p><u>The Municipality should evaluate utility allowance rate each year as established in the federal regulations.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-09.</p>
02-20	14.871	<p><u>The Municipality should improve monitoring procedures to assure that annual inspections and quality control re-inspections are properly documented in the participant files and to assure that the exceptions detailed in the inspection reports are duly corrected by the owner or the participant in the required period.</u></p> <p>No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 03-10.</p>
01-04	14.228	<p><u>Municipality did not apply adequately the monitoring system developed to ensure contractors compliance with payment of prevailing wages rates to employees.</u></p> <p>Full corrective action has been taken.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
01-05	14.228	<u>The Municipality did not maintain adequate property records.</u> Full corrective action has been taken.
01-06	14.228	<u>Procurement and Suspension and Debarment - Contract's Provisions</u> Full corrective action has been taken.
00-III-02	14.228	<u>The Davis-Bacon Act monitoring system procedures should be applied consistently</u> Full corrective action has been taken.
00-III-03	14.228	<u>Procurement process should be adequately documented</u> Full corrective action has been taken.

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF LUQUILLO

**BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION**

YEAR ENDED JUNE 30, 2003

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2003

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
the Municipal Legislature
Municipality of Luquillo
Luquillo, 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 Luquillo, Puerto Rico**, as of and for the year ended June 30, 2003, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

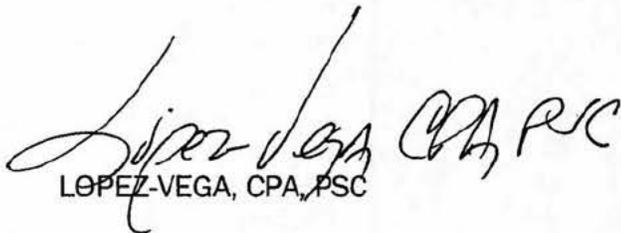
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo, Puerto Rico**, as of June 30, 2003, and the respective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

As described in Note 1, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-for States and Local Governments, and has adopted paragraphs six to eleven of GASB Statement No. 38, Certain Financial Statements Note Disclosures, as of June 30, 2003.

INDEPENDENT AUDITORS' REPORT (Continued)

In addition, the Municipality adopted a prospective reporting of its general infrastructure assets.

The Management's Discussion and Analysis on pages 3 through 10 and the Budgetary Comparison Schedule-General Fund on page 39 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.


LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 18, 2003

Stamp No. 1942248 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS

YEAR ENDED JUNE 30, 2003

Management's Discussion and Analysis

Management of the Municipality of Luquillo (the "Municipality") implemented Statement No. 34 ("Statement") of the Governmental Accounting Standards Board ("GASB"), Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments for the fiscal year ended on June 30, 2003. This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of such Statement, and it has been designed accordingly with the following goals:

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

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

FINANCIAL HIGHLIGHTS

- The Municipality net assets decreased by \$ 1,341,488.
- In the fund financial statements, the governmental activities revenue increased \$ 90,455 while governmental activities expenditures increased \$ 2,158,574 (or 25%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$ 611,943.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$ 89,215.
- The Municipality issued bonds amounting to \$4,430,000 to finance the capital projects.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Using This Annual Report

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Asset presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements, focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Fund Financial Statements (Continued)

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Infrastructure Assets

Historically, a government's largest group of assets (infrastructure-roads, bridges, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the Governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrated its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

The Municipality commenced the reporting of infrastructure assets during the current year. Also, the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's combined net assets (excess of assets over liabilities) totaled \$ 10,606,887 at the end of 2003, compared to \$11,948,375 at the end of the previous year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

Net Assets (Continued)

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Condensed Statement of Net Assets
June 30, 2003

Current assets	\$ 9,205,999
Capital assets	<u>12,234,303</u>
Total assets	<u>21,440,302</u>
Current liabilities	1,511,163
Noncurrent liabilities	<u>9,322,252</u>
Total liabilities	<u>10,833,415</u>
Invested in capital assets, net of related debt	6,578,303
Restricted	6,173,779
Unrestricted (deficit)	<u>(2,145,195)</u>
Total net assets	<u>\$10,606,887</u>

Changes in Net Assets

The Municipality's net assets decreased by \$ 1,341,488. Approximately 50 percent of the Municipality's total revenue came from taxes, while 46 percent resulted from grants and contributions, including federal aid. Charges for Services provided less than 1 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works, health and welfare, culture and recreation, community development, economic development and public safety. In future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

Changes in Net Assets (Continued)

Condensed Statement of Activities
June 30, 2003 -

Program revenues:	
Charges for services	\$ 86,952
Operating grants and contributions	1,683,041
Capital grants and contributions	118,587
General revenues:	
Property taxes	3,456,412
Municipal license tax	725,092
Grants and contributions not restricted to specific programs	2,507,181
Other local taxes	456,059
Interest and investment earnings	78,668
Miscellaneous	<u>75,670</u>
Total revenues	<u>9,187,662</u>
Expense:	
General government	4,554,241
Public safety	63,574
Public works	2,725,523
Culture and recreation	471,750
Health and welfare	2,042,843
Community development	322,485
Economic development	231,477
Interest on long-term debt	<u>117,257</u>
Total expenses	<u>10,529,150</u>
Change in net assets	(1,341,488)
Net assets, beginning of year	<u>11,948,375</u>
Net assets, end of year	<u>\$ 10,606,887</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2003

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$7,694,836, an increase of \$3,405,333 in comparison with the prior year. There are reservations of fund balance amounting to \$6,480,744. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$306,965), 2) to pay debt service (\$1,318,315), 3) to pay for capital projects (\$4,480,816) and 4) for other purposes (\$374,648).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2003, the general fund has a fund balance of \$1,521,057.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2003, amounts to \$ 17,610,696, net of accumulated depreciation of \$ 5,376,392, leaving a net book value of \$ 12,234,303. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total decrease in the Municipality's investment in capital assets for the current fiscal year was \$ 132,444 in terms of net book value. Depreciation charges for the year totaled \$ 672,995.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2003 the Municipality has \$4,538,661 of unexpended proceeds from bond issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged. See "Limitations on Ability of Municipalities to Issue General Obligation Debt-The Municipal Bonds" for a general description of such limitations.

The applicable law also requires that in order for a municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT AND DISCUSSION ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2003

CAPITAL ASSETS AND DEBT ADMINISTRATION (Continued)

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal years.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, 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.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Net Assets
June 30, 2003

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 2,209,102
Cash with fiscal agent	6,048,575
Accounts receivable:	
Municipal license tax	
Intergovernmental	930,583
Other	17,739
Capital assets	
Land, improvements, and construction in progress	1,825,177
Other capital assets, net of depreciation	10,409,126
Total capital assets	<u>12,234,303</u>
 Total assets	 <u>21,440,302</u>
 Liabilities	
Accounts payable and accrued liabilities	672,698
Due to other governmental entities	77,517
Deferred revenues:	
Municipal license tax	466,238
Federal grant revenues	294,710
Other	
Noncurrent liabilities:	
Due within one year	768,016
Due in more than one year	<u>8,554,236</u>
 Total liabilities	 <u>10,833,415</u>
 Net Assets	
Invested in capital assets, net of related debt	6,578,303
Restricted for:	
Capital projects	4,480,816
Debt service	1,318,315
Other Purposes	374,648
Unrestricted (deficit)	<u>(2,145,195)</u>
 Total net assets	 <u>\$ 10,606,887</u>

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Activities
For the Year Ended June 30, 2003

Functions/Programs	Expenses	Program Revenues		Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions		
General government	\$ 4,554,241	\$ -	\$ 61,653	\$ 24,871	\$ (4,467,717)
Public safety	63,574	913			(62,661)
Public works	2,725,523	23,745	196,147	63,716	(2,441,915)
Health and welfare	2,042,843	13,748	916,027		(1,113,068)
Culture and recreation	471,750	48,546	55,822		(367,382)
Economic development	231,477		192,771		(38,706)
Community development	322,485		260,621	30,000	(31,864)
Interest on long-term debt	117,257				(117,257)
Total governmental activities	\$ 10,529,150	\$ 86,952	\$ 1,683,041	\$ 118,587	(8,640,570)
General revenues:					
Property taxes					3,456,412
Municipal license tax					725,092
Other Local Taxes					456,059
Grants and contributions not restricted to specific programs					2,507,181
Interest and investment earnings					78,668
Miscellaneous					75,670
Total general revenues					7,299,082
Change in net assets					(1,341,488)
Net assets - beginning					11,948,375
Net assets - ending					\$ 10,606,887

Commonwealth of Puerto Rico
Municipality of Luquillo
Balance Sheet
Governmental Funds
June 30, 2003

	General Fund	Special Revenue Fund Federal Grants	Capital Project Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents	\$ 1,453,515	\$ 411,888	\$ -	\$ -	\$ 343,699	\$ 2,209,102
Cash with fiscal agent		133,363	4,538,661	1,318,315	58,236	6,048,575
Accounts receivable:						
Intergovernmental	329,925	563,095			37,563	930,583
Prepaid Expenses	17,739				-	17,739
Due from other funds	733,317				-	733,317
Total assets	\$ 2,534,496	\$ 1,108,346	\$ 4,538,661	\$ 1,318,315	\$ 439,498	\$ 9,939,316
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 469,684	\$ 170,504	\$ 26,377	\$ -	\$ 6,133	\$ 672,698
Due to other governmental entities	77,517					77,517
Due to other funds		506,254	31,468		195,595	733,317
Deferred revenues:						
Municipal license tax	466,238					466,238
Federal grant revenues		251,491			43,219	294,710
Other						-
Total liabilities	1,013,439	928,249	57,845	-	244,947	2,244,480
Fund balances:						
Reserved for:						
Encumbrances	306,965					306,965
Capital projects			4,480,816			4,480,816
Other purposes		180,097			194,551	374,648
Reserved reported in nonmajor funds:						
Debt service fund				1,318,315		1,318,315
Unreserved:						
Undesigned	1,214,092					1,214,092
Total fund balances	1,521,057	180,097	4,480,816	1,318,315	194,551	7,694,836
Total liabilities and fund balances	\$ 2,534,496	\$ 1,108,346	\$ 4,538,661	\$ 1,318,315	\$ 439,498	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	12,234,303
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	(9,322,252)
Net assets of governmental activities	\$ 10,606,887

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2003

	General Fund	Special Revenue Fund Federal Grants	Capital Project Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 2,990,915	\$ -	\$ -	\$ 465,497	\$ -	\$ 3,456,412
Municipal license taxes	725,092					725,092
Licenses, permits and other local taxes	467,423					467,423
Charges for services	41,388					41,388
Intergovernmental	2,568,834	14,697	93,716		271,917	2,949,164
Rent of property	33,287					33,287
Fines and forfeitures	913					913
Interest	78,668					78,668
Federal grants		837,769			438,220	1,275,989
Miscellaneous	74,310		37		60,108	134,455
Total revenues	6,980,830	852,466	93,753	465,497	770,245	9,162,791
Expenditures						
Current:						
General government	4,151,228		282,607		3,860	4,437,695
Public safety	127,223					127,223
Public works	1,712,274	492,155	327,884		110,049	2,642,362
Health and welfare	1,111,450	439,162			490,261	2,040,873
Culture and recreation	414,462		17,476		43,031	474,969
Economic development	35,136				196,197	231,333
Community development		260,621	51,125			311,746
Principal				325,000		325,000
Interest				117,257		117,257
Total expenditures	7,551,773	1,191,938	679,092	442,257	843,398	10,708,458
Excess (deficiency) of revenues over (under) expenditures	(570,943)	(339,472)	(585,339)	23,240	(73,153)	(1,545,667)
Other financing sources (uses)						
Transfers in				41,000		41,000
Transfers out	(41,000)					(41,000)
Long-term debt issued		521,000	4,430,000			4,951,000
Total other financing sources (uses)	(41,000)	521,000	4,430,000	41,000	-	4,951,000
Excess (deficiency) of revenues over expenditures and other financing sources (uses)	(611,943)	181,528	3,844,661	64,240	(73,153)	3,405,333
Fund balance, beginning	2,133,000	(1,431)	636,155	1,254,075	267,704	4,289,503
Fund balance, ending	\$ 1,521,057	\$ 180,097	\$ 4,480,816	\$ 1,318,315	\$ 194,551	\$ 7,694,836

The notes to the financial statements are an integral part of this statement.

Commonwealth of Puerto Rico
Municipality of Luquillo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2003

Net Change in Fund Balances - Total Governmental Funds \$ 3,405,333

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 515,680

Depreciation expense on capital assets is reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. (672,995)

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in Governmental Funds. (131,871)

Some revenues reported in the Statements of Activities do not provide current financial resources in Governmental Funds. 143,494

Some expenses reported in the Governmental Funds require the use of current financial resources and, therefore, are not reported as expenditures in Statement of Activities. 24,871

The issuance of long-term debt provides current financial resources to Governmental Funds, while the repayment of principal of long-term debt consumes current financial resources. This is the amount by which debt proceeds exceed debt service principal payments. (4,626,000)

Change in Net Assets of Governmental Activities \$ (1,341,488)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Luquillo (the Municipality) was founded on the year 1797. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. With this financial report, the Municipality has changed its financial reporting to comply with the provisions of GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. As part of the implementation of GASB Statement No. 34, the Municipality adopted a prospective reporting of its general infrastructure assets. This result in the recognition of the costs incurred during the fiscal year ended June 30, 2003 for the acquisition of infrastructure assets (e.g., roads, bridges, sidewalks). The Municipality expects to report the retroactive historical costs of all of its infrastructure assets during the fiscal year beginning on July 1, 2003.

In conjunction with the implementation of GASB Statement No. 34, the Municipality has also implemented paragraphs six to eleven of GASB Statement No. 38, Certain Financial Statements Note Disclosures, which rescinds some and modifies other financial statement disclosure requirements. As part of the implementation of Statement No. 34, the Municipality revised the classification of its funds. Accordingly, beginning fund balances were restated as explained in Note 12.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Component Units

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 are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are 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.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund- is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund - Federal Grants- is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Project Fund - Local, State and Federal Grants - is the accounting entity in which revenues derived from local funds, state and federal grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Fund - is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund- General Fund is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund - Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Funds- Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

Capital Projects Funds - Local, State and Federal Grants - Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

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 are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, rent, 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. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue 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. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. 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, then unrestricted resources, as they are needed.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The preparation of the 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

- 1. Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services 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.

- 2. 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."

Advances between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent mostly contributions from the Puerto Rico Electric Power Authority, which contribute a specific percentage of their revenues as payment in lieu of taxes. Intergovernmental receivable in the special revenue fund represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

- 3. Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

6. **Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

7. **Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The municipality has the following reservations of fund balance:
 - a. *Capital Projects-* Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
 - b. *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.
 - c. *Other Purposes-* Represents net assets available for specific use and/or legally segregated for other specific future use.
 - d. *Debt Service Fund-* Represents net assets available to finance future debt service payments.
9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
 - a. *Operating Transfers-* Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. *Intra-Entity Transactions-* Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
10. **Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2003 amounted to approximately \$230,765. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$135,011 for workers compensation insurance covering all municipal employees.

1.1. Reconciliation of Government-wide and Fund Financial Statements

The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that "capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The details of this reconciliation are as follows:

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$12,234,303	
Deduct:		
Bonds Payable	(4,835,000)	
Notes Payable	(821,000)	6,578,303
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		4,480,816
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service		1,318,315
<u>Net assets restricted for other purposes</u>		
Other governmental funds - fund balance restricted for other purposes		\$374,648
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$1,521,057	
Deduct:		
Bond and Notes	(1,420,000)	
Compensated absences debt	(733,373)	
Social Security - Treasury Department	(107,955)	
Property Tax - Treasury Department	(6,648)	
Property Tax - CRIM Law 42	(533,459)	
Property Tax - CRIM Law 146	(700,940)	
Property Tax - CRIM Liquidation 2001-2002	<u>(163,877)</u>	<u>(2,145,195)</u>
Total net assets - governmental activities		<u>\$10,606,887</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

2. 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 balances in commercial banks of approximately \$1,453,515 and \$411,888, in the general fund and special revenue fund - federal grants, respectively, were fully collateralized at June 30, 2003. In the other governmental funds there were deposits with commercial banks of approximately \$343,699, respectively, that were fully collateralized.

The deposits at GDB of approximately the \$133,363 in the special revenue fund - federal grant, \$4,538,661, that is restricted principally for capital projects in the capital project fund - local, state and federal grants, the \$1,318,315 in the debt service fund, , and the \$58,236 that is restricted for other purposes in the other governmental funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 24 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2003, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 24. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2003, net of allowance for uncollectibles.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

3. RECEIVABLES (CONTINUED)

B. *Intergovernmental Receivables*- Intergovernmental receivables in the general fund principally consist of the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from the revenues the Municipality is entitled to receive in lieu of payment of taxes, and the amounts due from the Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico resulting from the excess of current year property tax collections over current year advances. The amounts receivable from governmental entities are as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$329,925
Total	<u>\$329,925</u>

Intergovernmental receivable in special revenue funds represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$42,095
Community Facilities Loan	<u>521,000</u>
Total	<u>\$563,095</u>

Intergovernmental receivable in other governmental funds represents expenditures incurred not yet reimbursed by the state and local government. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Department of Labor	<u>\$37,563</u>
Total	<u>\$37,563</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2003, and interfund transfers during the fiscal year ended at June 30, 2003, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - Federal Grants	Payroll and related accruals paid and not reimbursed by the Federal Programs	\$506,254
General Fund	Capital Project Fund - State and Local Grants	Payroll and related accruals paid and not reimbursed by the Capital Project Funds	31,468
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed by Other Governmental Funds	<u>195,595</u>
Total			<u>\$733,317</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$41,000
Total			<u>\$41,000</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2003, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2002</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2003</u>
Capital asset, not being depreciated:				
Land	\$1,800,306	\$24,871		\$1,825,177
Construction in progress	_____	_____	\$ -	_____
Total capital assets not being depreciated	<u>1,800,306</u>	<u>24,871</u>	-	<u>1,825,177</u>
Capital assets, being depreciated:				
Buildings	\$11,355,667			\$11,355,667
Buildings improvements	81,603	206,515		288,118
Infrastructure		8,292		8,292
Infrastructure improvements		96,023		96,023
Equipment	1,433,750	57,217		1,490,967
Furnishing	495,837	447		496,284
Work of art	400			400
Computers	134,550	12,887		147,437
Vehicles	<u>1,768,031</u>	<u>134,299</u>	-	<u>1,902,330</u>
Total capital assets being depreciated	<u>\$15,269,838</u>	<u>\$515,680</u>	-	<u>\$15,785,518</u>
Less accumulated depreciation for:				
Buildings	(\$1,673,614)	(\$283,892)		(\$1,957,506)
Buildings improvements	(11,304)	(3,902)		(15,206)
Infrastructure		(559)		(559)
Infrastructure improvements		(864)		(864)
Equipment	(1,100,669)	(155,140)		(1,255,809)
Furnishing	(282,091)	(72,353)		(354,444)
Works of art	(3)	(40)		(43)
Computers	(107,342)	(21,272)		(128,614)
Vehicles	<u>(1,528,374)</u>	<u>(134,973)</u>	-	<u>(1,663,347)</u>
Total accumulated depreciation	<u>(\$4,703,397)</u>	<u>(\$672,995)</u>	-	<u>(\$5,376,392)</u>
Total capital assets being depreciated, net	<u>\$10,566,441</u>	<u>(157,315)</u>	-	<u>\$10,409,126</u>
Governmental activities capital assets, net	<u>\$12,366,747</u>	<u>(\$132,444)</u>	-	<u>\$12,234,303</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

5. CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to functions/programs of the Municipality as follows:

Governmental activities:

General government	\$368,677
Public safety	13,625
Public works	139,702
Culture and recreation	74,090
Health and welfare	66,018
Community development	10,739
Economic development	<u>144</u>

Total depreciation expense-governmental activities \$672,995

6. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

6. PROPERTY TAXES (CONTINUED)

On December 31, 1992 the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2003, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$6,648 and is payable as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2004	<u>\$6,648</u>
Total	<u>\$6,648</u>

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money. A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

6. PROPERTY TAXES (CONTINUED)

The government-wide statement of net assets includes an outstanding balance of \$700,940, 163,877 and 533,459 related to Law 146, 2001-2002 CRIM final liquidation and Law 42.

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 Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$ 50,000 of the assessed value to retailers having annual net sales of less than \$ 150,000.

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

7. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of approximately \$466,238 in the general fund relates to municipal license tax collected in fiscal year 2002-03 that will be earned in fiscal year 2003-04.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

7. DEFERRED REVENUES (CONTINUED)

B. Federal Government- The deferred revenues presented in other governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Rental Voucher Program	\$43,218
Incentive Grant - Department of Transportation	27,897
Emergency Management Performance Grant	116,402
Emergency Management Act	12,871
Housing Preservation Grant	718
Nutrition Program for the Elderly	8,636
Community Development Block Grant	5,233
Title V - Delinquency Prevention Program	930
Special Program for Aging Title III	22,163
Community Service Block Grant	1,870
Child Care Block Grant	50,412
Hazard Mitigation Grant	<u>4,360</u>
Total	<u>\$294,710</u>

8. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2003, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$1,970,000	\$4,430,000	\$145,000	\$6,255,000	\$230,000
Notes Payable	480,000	521,000	180,000	821,000	264,000
Property Tax Advance - Treasury Department	7,598		950	6,648	950
Social Security - Treasury Department	143,955		36,000	107,955	36,000
CRIM - Property Tax- Law 146	700,940			700,940	
CRIM - Property Tax- Liquidation 2001-2002	163,877			163,877	163,877
CRIM - Property Tax- Law 42	576,023		42,564	533,459	42,560
Compensated Absences	637,982	131,871	36,480	733,373	30,629
Claims and judgments	<u>27,500</u>		<u>27,500</u>		
Total	<u>\$4,707,875</u>	<u>\$5,082,871</u>	<u>\$468,494</u>	<u>\$9,322,252</u>	<u>\$768,016</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

8. LONG-TERM LIABILITIES (CONTINUED)

1. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.
2. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality issued bonds for approximately \$4,430,000. Bonds payable outstanding at June 30, 2003 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2003</u>
1985 Series	7-1-04	\$ 319,000	8.00 %	\$ 40,000
1993 Series	7-1-12	2,015,000	5.00% to 8.00%	1,380,000
2000 Series	7-1-14	460,000	2.70% to 7.81%	405,000
2003 Series	7-1-27	4,430,000	5.00% to 6.50%	4,430,000
Total general obligation bonds				<u>\$6,255,000</u>

These bonds, except the 1985 Series bond, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 230,000	\$ 288,338
2005	210,000	394,340
2006	220,000	379,667
2007	235,000	364,017
2008	255,000	347,072
2009-2013	1,595,000	1,428,592
2014-2018	895,000	990,959
2019-2023	1,105,000	679,413
2024-2028	<u>1,510,000</u>	<u>258,375</u>
Total	<u>\$6,255,000</u>	<u>\$5,130,773</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

8. LONG-TERM LIABILITIES (CONTINUED)

3. **Notes Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2003</u>
1993 Series	7-1-03	525,000	4.87% to 6.71%	\$ 110,000
2000 Series	7-1-04	425,000	2.70% to 7.81%	190,000
2003 Series	1-1-10	521,000	4.75%	521,000
Total notes payable				<u>\$821,000</u>

The notes are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 264,000	\$ 11,819
2005	168,000	23,108
2006	71,000	18,478
2007	74,000	15,105
2008	78,000	11,590
2009-2013	166,000	11,922
2014-2018		
2024-2028		
Total	<u>\$821,000</u>	<u>\$92,022</u>

4. **Property Tax Debt-** These amounts represent the balance owned to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2003, as described in Note 6, from property tax advances in excess of actual collections and other property tax debts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

8. LONG-TERM LIABILITIES (CONTINUED)

5. **Compensated absences-** The government-wide statement of net assets includes approximately \$398,309 of accrued sick leave benefits, and approximately \$335,064 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

9. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

9. PENSION PLAN (CONTINUED)

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2003 amounted to approximately \$192,872 and \$216,180, respectively.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation 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 1, 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. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up 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 a 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.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2003, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

10. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department 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.

11. CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2003

12. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$251,694 to properly present the previously reported fund balance at June 30, 2002. The restatement is mainly due to the reclassification of beginning cash balances.

The beginning Fund Balance for Special Revenue has been restated by approximately \$392,146 to properly presents the previously reported fund balance at June 30, 2002. The restatement is mainly due to the reclassification of beginning cash balances.

The beginning Fund Balances for Debt Service Fund has been restated by approximately \$480,663 to properly present the previously reported fund balances at June 30, 2002. The restatement is mainly due to the recognition of the amount due to CRIM related to Final Liquidation 2001-2002.

The beginning Fund Balances for Capital Projects Funds has been restated by approximately \$127,254 to properly present the previously reported fund balances at June 30, 2002. The restatement is mainly due to the reclassification of beginning cash balances.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2003

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES AND OTHER FINANCING SOURCES:				
Property taxes	\$2,720,455	\$2,720,455	\$2,480,053	(\$240,402)
Municipal license tax	591,850	712,203	725,092	12,889
Licenses, permits and other local taxes	356,000	426,504	467,423	40,919
Charges for service	57,780	38,756	41,388	2,632
Intergovernmental	2,532,896	2,538,612	2,568,834	30,222
Rent of property	24,720	27,045	33,287	6,242
Fines and forfeitures	1,100	865	913	48
Interest	30,000	45,810	78,668	32,858
Miscellaneous	126,500	148,252	255,247	106,995
Operating transfer from other fund				
Total revenues and other financing sources before carryover	<u>6,441,301</u>	<u>6,658,502</u>	<u>6,650,905</u>	<u>(7,597)</u>
Budget carryover (1)		600,094	600,094	
Total revenues and other financing sources after carryover	<u>6,441,301</u>	<u>7,258,596</u>	<u>7,250,999</u>	<u>(7,597)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	3,405,194	3,937,046	3,922,961	14,085
Public safety	105,475	107,863	102,675	5,188
Public works	1,452,008	1,605,910	1,561,621	44,289
Health and welfare	1,085,987	1,101,886	1,086,678	15,208
Culture and recreation	310,810	427,520	412,273	15,247
Economic development	40,827	37,371	34,576	2,795
Community development				
Urban development				
Education				
Operating transfer to other fund	<u>41,000</u>	<u>41,000</u>	<u>41,000</u>	<u>—</u>
Total expenditures, encumbrances and other financing uses	<u>6,441,301</u>	<u>7,258,596</u>	<u>7,161,784</u>	<u>96,812</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>—</u>	<u>—</u>	<u>89,215</u>	<u>89,215</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$7,250,999
Differences-budget to GAAP:				
Budget Carryover				(600,094)
Account Receivable from CRIM at June 30, 2003				<u>329,925</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$6,980,830</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$7,161,784
Differences-budget to GAAP:				
Payments of prior year accounts payable recorded as expenditures for GAAP basis				(69,491)
Prior year encumbrances recorded as current year expenditures for GAAP basis				671,934
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(171,454)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$7,592,773</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

BUDGETARY COMPARISON SCHEDULE- GENERAL FUND (CONTINUED)
(NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2003

1. 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 fund.

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.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2003 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2003.