

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SINGLE AUDIT REPORT
YEAR ENDED JUNE 30, 2004

Cant 1105 - 9114

Dr. Li

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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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, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We 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.

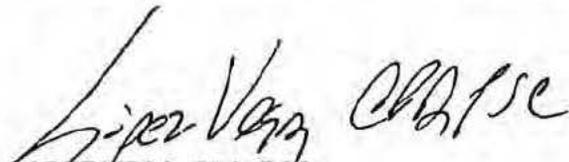
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo, Puerto Rico**, as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on page 42 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In accordance with *Government Auditing Standards*, we have also issued our report dated January 24, 2005 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts 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
January 24, 2005

Stamp No. 2019454 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'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2004

This discussion and analysis of the Municipality of Luquillo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2004. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2003, first year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements - and Management's Discussion and Analysis-for State and Local Governments.*" This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the indicated fiscal year, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. asses management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2004 constitute factual evidence of the Municipality's economic strength by the end of such year. The following comments deserve special mention:

1. Total assets of the Municipality amounted to \$26,449,271 which represents an increase of 22% compared to prior fiscal year;
2. At the end of fiscal year 2004, total liabilities amounted to \$11,738,542. Out of said amount, \$8,954,690 corresponded to long-term liabilities of which \$6,810,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total net assets of the Municipality amounted to \$14,710,729 which represents an increase of 37% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$13,623,892, derived from the following sources: \$63,287 charges for services; \$2,513,056 from operating grants and contributions; \$2,536,506 from capital grants and contributions obtained from other sources, and \$8,511,043 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL HIGHLIGHTS (continued)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$9,665,311;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to the increase in the Net Assets Figure by \$3,958,581;
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$7,145,368;
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$1,966,988. It is pertinent to note that it is the municipal administration's contention that the importance of such figure should not be overestimated since it has adopted the policy to use internal generated resources to increase services to Municipality's community rather than let them unused in the accounted records;
9. In accordance with the aforementioned policy, during fiscal year 2004 the Municipality used \$539,420 available in the General Fund Balance Account of previous year for further increases in capital assets and for the extension of several municipal services to Luquillo's communities.
10. The actual General Fund budgetary activities resulted in a favorable balance of \$854,208 which is indicative of full compliance with the balanced budget principle applicable to all municipalities of the Commonwealth Government of Puerto Rico as required by the Municipal Autonomous Act enacted in August 1991.
11. In response to the continued increments in the municipal operating revenues, the Municipal Legislature approved a revision to the General Fund Budget for fiscal year 2004 which amounted to \$906,045.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2004. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds. This in turn will benefit the welfare of Luquillo constituents.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2004, shows total expenses incurred to afford the cost of all functions and programs amounted to \$9,665,311. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$5,112,849 was derived from the following sources: \$63,287 charges for services; \$2,513,056 from operating grants and contributions; and \$2,536,506 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$8,511,043. When such figure is added to the \$5,112,849 previously mentioned, total revenues available for the financing of activities amounted to \$13,623,892. There was an excess of revenues over expenses in the amount of \$3,958,581 which contributed to the figure of net assets attained at the end of the fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (continued)

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As explained in the Capital Assets and Debt Administration Section of this MD&A, on July 1, 2002, the Municipality commenced partially the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

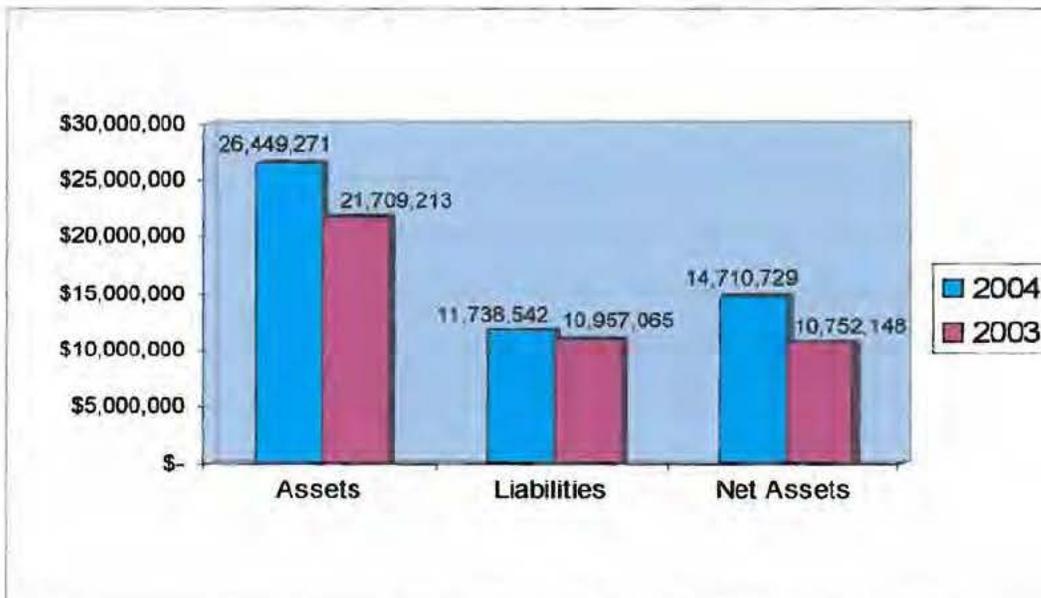
YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Luquillo, primary government assets exceeded total liabilities by \$14,710,729 at the end of 2004, compared to \$10,752,148 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets	2004	2003	Change	%
Current and other assets	\$ 9,777,412	\$ 9,474,910	\$ 302,502	3%
Capital assets	16,671,859	12,234,303	4,437,556	36%
Total assets	26,449,271	21,709,213	4,740,058	22%
Current and other liabilities	2,783,852	1,634,813	1,149,039	70%
Long-term liabilities	8,954,690	9,322,252	(367,562)	(4%)
Total liabilities	11,738,542	10,957,065	781,477	7%
Invested in capital assets, net of related debt	11,146,859	6,578,303	4,568,556	69%
Restricted	5,026,572	6,318,003	(1,291,431)	(20%)
Unrestricted deficit	(1,462,702)	(2,144,158)	681,456	(32%)
Total net assets	\$14,710,729	\$10,752,148	\$3,958,581	37%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (continued)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2004, the net effect of the revenues derived from several programs plus current operating revenues, amounted to \$3,958,581. Approximately 38 percent of the Municipality's total revenue came from taxes, while 59 percent resulted from grants and contributions, including federal aid. The largest expenses were for general government, culture and recreation, and health and welfare services. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

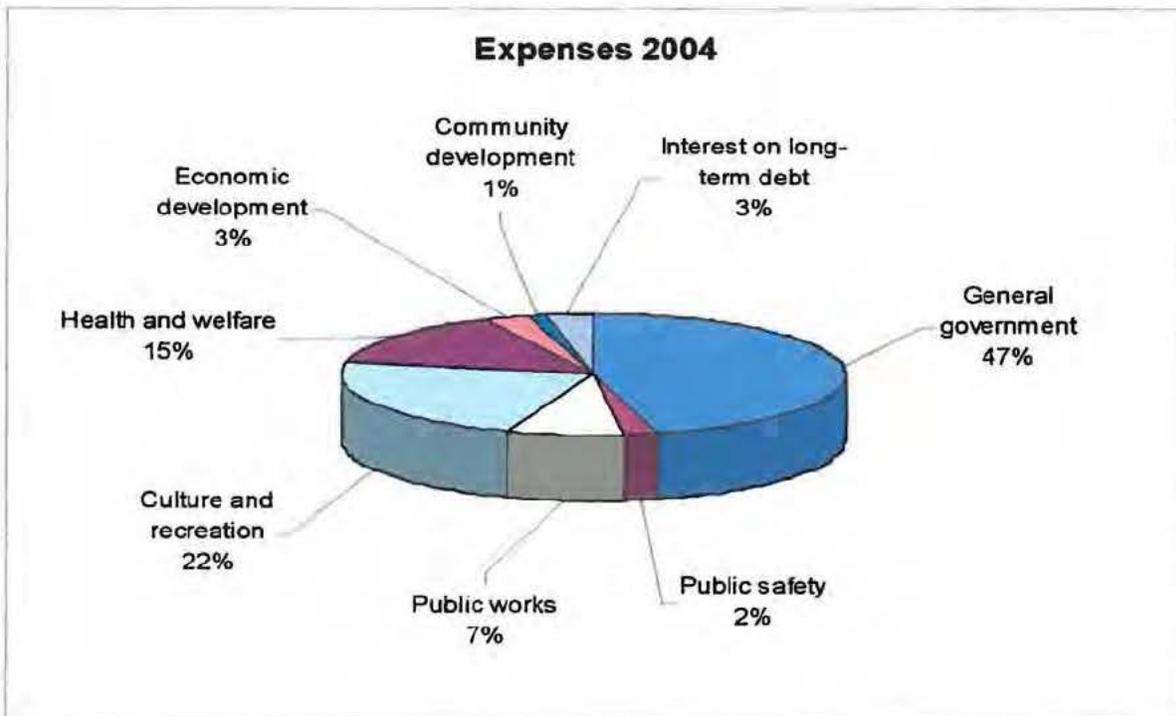
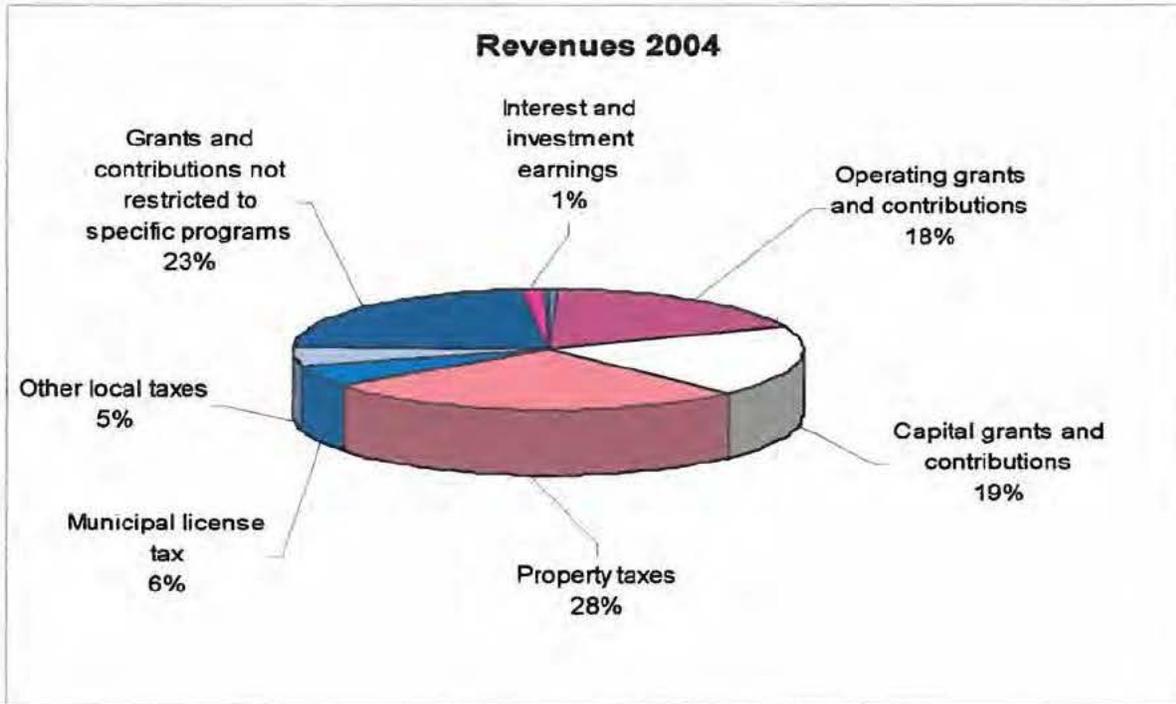
Condensed Statement of Activities	2004	2003	Change	%
Program revenues:				
Charges for services	\$ 63,287	\$ 86,952	\$ (23,665)	(27%)
Operating grants and contributions	2,513,056	1,683,041	830,015	49%
Capital grants and contributions	2,536,506	118,587	2,417,919	2039%
General revenues:				
Property taxes	3,722,173	3,724,286	(2,113)	-
Municipal license tax	789,502	725,092	64,410	9%
Other local taxes	699,266	456,059	243,207	53%
Grants and contributions not restricted to specific programs	3,054,553	2,507,181	547,372	22%
Interest and investment earnings	193,473	79,705	113,768	143%
Gain (loss) on sale of capital assets	5,747		5,747	100%
Miscellaneous	46,329	75,670	(29,341)	(39%)
Total revenues	13,623,892	9,456,573	4,167,319	44%
Expenses:				
General government	4,419,076	4,554,241	(135,165)	(3%)
Public safety	237,037	63,574	173,463	273%
Public works	722,194	2,725,523	(2,003,329)	(74%)
Culture and recreation	2,162,118	471,750	1,690,368	358%
Health and welfare	1,442,732	2,042,843	(600,111)	(29%)
Economic development	290,627	231,477	59,150	26%
Community development	84,362	322,485	(238,123)	(74%)
Interest on long-term debt	307,165	117,257	189,908	162%
Total expenses	9,665,311	10,529,150	(863,839)	(8%)
Change in net assets	3,958,581	(1,072,577)	5,031,158	(469%)
Net assets, beginning of year, as restated	10,752,148	11,824,725	(1,072,577)	(9%)
Net assets, end of year	\$ 14,710,729	\$ 10,752,148	\$ 3,958,581	37%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (continued)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

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 \$7,145,368, a decrease of \$818,379 in comparison with the prior year. There are reservations of fund balance amounting to \$5,818,182. 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 (\$639,802), 2) to pay debt service (\$1,592,404), 3) to pay for capital projects (\$3,289,564) and 4) for other purposes (\$296,412).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has an undesignated fund balance of \$1,327,186.

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.

During the fiscal year 2004 the Municipality used \$539,420 available in the General Fund Undesignated Fund Balance Account of previous year for further increases in capital assets and for the extension of several municipal services to Luquillo's communities.

In response to the increments in the municipal operating revenues, the Municipal Legislature approved a revision to the General Fund Budget for fiscal year 2004 which amounted to \$906,045. Such increments were used to provide further increases in capital assets and for the extension of several municipal services to Luquillo's communities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has not maintained complete and adequate records related to the Capital Assets acquired and constructed in the past years, but the Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets, and then, comply with such requirement. The Municipal Administration expects to develop a broad and comprehensive identification and assessments project of all fixed assets owned by the local government in order to capitalize them in its Statement of Net Assets, and then, reflects the correct net assets figure of the Municipality as a whole.

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$22,667,730, net of accumulated depreciation of \$5,995,871 (including \$619,478 of current year depreciation expense), leaving a net book value of \$16,671,859. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. 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 Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes 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, 2004, the Municipality has \$3,851,078 of unexpended proceeds from bond and notes 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.

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'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

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 and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State 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 fiscal year 2004-2005.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

On September 7, 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. This Law stipule a new formula to determine the contribution in lieu of taxes to be distributed by the Puerto Rico Electric Power Authority (PREPA), which, pays the municipalities as contributions in lieu of taxes greater of the following amounts: (a) twenty percent (20%) of its net revenues as defined in the Trust Indenture signed with the Trustee as representative of the bondholders, adjusted by subsidies granted by the PREPA; (b) an amount equal to the actual cost of electric power consumed by each Municipality in its common facilities during the current year; or (c) an average of the contribution in lieu of taxes paid by PREPA to each municipality during the past five fiscal years. Also, in addition to the new formula established for the calculation of the contribution in lieu of taxes as described above, applicable on fiscal year 2004-2005 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINAL COMMENTS (continued)

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2004. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

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 at P.O. Box 1012, Luquillo, Puerto Rico 00773-1012, or call (787) 889-2068.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Net Assets
June 30, 2004

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 2,994,021
Cash with fiscal agent	5,531,253
Accounts receivable:	
Intergovernmental	1,222,178
Other	29,960
Capital assets	
Land, improvements, and construction in progress	6,207,583
Other capital assets, net of depreciation	10,464,276
Total capital assets	<u>16,671,859</u>
Total assets	<u>26,449,271</u>
Liabilities	
Accounts payable and accrued liabilities	1,595,710
Due to other governmental entities	110,710
Deferred revenues:	
Municipal license tax	506,750
Federal grant revenues	418,874
Interest payable	151,808
Noncurrent liabilities:	
Due within one year	532,040
Due in more than one year	8,422,650
Total liabilities	<u>11,738,542</u>
Net Assets	
Invested in capital assets, net of related debt	11,146,859
Restricted for:	
Capital projects	3,289,564
Debt service	1,440,596
Other Purposes	296,412
Unrestricted (deficit)	<u>(1,462,702)</u>
Total net assets	<u>\$ 14,710,729</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, 2004

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 4,419,076	\$ 10,030	\$ 104,591	\$ -	\$ (4,304,455)
Public safety	237,037	290	125,753		(110,994)
Public works	722,194	33,377	172,687	63,716	(452,414)
Health and welfare	2,162,118	13,969	988,809		(1,159,340)
Culture and recreation	1,442,732	5,621	8,250	2,472,790	1,043,929
Economic development	290,627		278,454		(12,173)
Community development	84,362		834,512		750,150
Interest on long-term debt	307,165				(307,165)
Total governmental activities	\$ 9,665,311	\$ 63,287	\$ 2,513,056	\$ 2,536,506	(4,552,462)
General revenues:					
Property taxes					3,722,173
Municipal license tax					789,502
Other Local Taxes					699,266
Grants and contributions not restricted to specific programs					3,054,553
Interest and investment earnings					193,473
Gain (loss) on sale/retirement of capital assets					5,747
Miscellaneous					46,329
Total general revenues					8,511,043
Change in net assets					3,958,581
Net assets - beginning, as restated					10,752,148
Net assets - ending					\$ 14,710,729

**Commonwealth of Puerto Rico
Municipality of Luquillo
Balance Sheet
Governmental Funds
June 30, 2004**

	General Fund	Special Revenue Fund - Local & State Grants	Special Revenue Fund Federal Grants	Capital Projects Fund - Local & State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents	\$ 1,893,375	\$ 469,897	\$ 552,176	\$ 15,188	\$ -	\$ 63,385	\$ 2,994,021
Cash with fiscal agent		58,450	133,363	3,851,078	1,488,362		5,531,253
Accounts receivable:							
Municipal license tax	11,575						11,575
Intergovernmental	265,154	104,717	746,460		105,847		1,222,178
Interest					953		953
Prepaid Expenses	17,432						17,432
Due from other funds	917,339						917,339
Total assets	\$ 3,104,875	\$ 633,064	\$ 1,431,999	\$ 3,866,266	\$ 1,595,162	\$ 63,385	\$ 10,694,751
Liabilities and Fund Balances							
Liabilities :							
Accounts payable and accrued liabilities	\$ 520,427	\$ 91,551	\$ 407,030	\$ 576,702	\$ -	\$ -	\$ 1,595,710
Due to other governmental entities	110,710						110,710
Due to other funds		286,111	612,308		2,758	16,162	917,339
Deferred revenues:							
Municipal license tax	506,750						506,750
Federal grant revenues			371,651			47,223	418,874
Total liabilities	1,137,887	377,662	1,390,989	576,702	2,758	63,385	3,549,383
Fund balances:							
Reserved for:							
Encumbrances	639,802						639,802
Capital projects				3,289,564			3,289,564
Other purposes		255,402	41,010				296,412
Debt service					1,592,404		1,592,404
Unreserved:							
Undesignated	1,327,186						1,327,186
Total fund balances	1,966,988	255,402	41,010	3,289,564	1,592,404	-	7,145,368
Total liabilities and fund balances	\$ 3,104,875	\$ 633,064	\$ 1,431,999	\$ 3,866,266	\$ 1,595,162	\$ 63,385	

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	16,671,859
Long-term liabilities, including accrued interest payable, are not due and payable in the current period, and therefore, are not reported in the funds	(9,106,498)
Net assets of governmental activities	\$ 14,710,729

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2004

	General Fund	Special Revenue Fund - Local & State Grants	Special Revenue Fund Federal Grants	Capital Projects Fund -Local & State Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues							
Property taxes	\$ 2,984,124	\$ -	\$ -	\$ -	\$ 738,049	\$ -	\$ 3,722,173
Municipal license taxes	789,502						789,502
Licenses, permits and other local taxes	707,780						707,780
Charges for services	22,697						22,697
Intergovernmental	3,159,144	574,689		63,716			3,797,549
Rent of property	31,786						31,786
Fines and forfeitures	290						290
Interest	193,473						193,473
Federal grants			1,365,428			417,073	1,782,501
Miscellaneous	56,634	219	15,976	54		35,299	108,182
Total revenues	7,945,430	574,908	1,381,404	63,770	738,049	452,372	11,155,933
Expenditures							
Current:							
General government	4,144,603			81,528			4,226,131
Public safety	97,678	116,005	4,577				218,260
Public works	1,705,580	125,176	384,765	147,869			2,363,390
Health and welfare	1,135,174	11,910	524,637			452,372	2,124,093
Culture and recreation	330,516	14,987		1,025,625			1,371,128
Economic development	13,458	278,333					291,791
Community development			834,512				834,512
Principal					494,000		494,000
Interest					279,007		279,007
Total expenditures	7,427,009	546,411	1,748,491	1,255,022	773,007	452,372	12,202,312
Excess (deficiency) of revenues over (under) expenditures	518,421	28,497	(367,087)	(1,191,252)	(34,958)		(1,046,379)
Other financing sources (uses)							
Transfers in		32,353			43,200		75,553
Transfers out	(75,553)						(75,553)
Long-term debt issued			228,000				228,000
Total other financing sources (uses)	(75,553)	32,353	228,000		43,200		228,000
Net change in fund balances	442,868	60,850	(139,087)	(1,191,252)	8,242		(818,379)
Fund balance, beginning, as restated	1,524,120	194,552	180,097	4,480,816	1,584,162		7,963,747
Fund balance, ending	\$ 1,966,988	\$ 255,402	\$ 41,010	\$ 3,289,564	\$ 1,592,404	\$ -	\$ 7,145,368

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, 2004

Net Change In Fund Balances - Total Governmental Funds	\$ (818,379)
 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.	5,061,865
Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change 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.	(619,478)
Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Change in Net Assets.	(4,831)
Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Assets, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represents the change in accrued interest from prior year.	(28,158)
Bonds and notes proceeds provides current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide Statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments.	266,000
Repayment of long term social security debt is an expenditure in Governmental Funds, but the repayment reduces long -term social security debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period.	36,000
Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period.	208,809
Long-term compensated absences are 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, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represented the change in long-term compensated absences from prior year.	<u>(143,247)</u>
Change in Net Assets of Governmental Activities	<u>\$ 3,958,581</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2004

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 a full range of services for its citizens. These services include 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.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2003. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality has elected to delay the capitalization of infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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, as amended by GASB Statement No. 39. 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, 2004

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 - State and Local 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 state statutes.

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 Projects Fund - Local and State 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 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, 2004

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 – State and Local 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.

Special Revenue Fund – Section 8 - Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

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.

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

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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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.

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 represents mostly contributions from the Puerto Rico Electric Power Authority (PREPA), which, pays the municipalities as contributions in lieu of taxes greater of the following amounts: (a) twenty percent (20%) of its net revenues as defined in the Trust Indenture signed with the Trustee as representative of the bondholders, adjusted by subsidies granted by the PREPA; (b) an amount equal to the actual cost of electric power consumed by each Municipality in its common facilities during the current year; or (c) an average of the contribution in lieu of taxes paid by PREPA to each municipality during the past five fiscal years.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

The contribution in lieu of tax revenue and related receivable recorded in the General Fund for the current fiscal year was determined based on the preliminary liquidation made by the PREPA. Such liquidation is subject to final results of the PREPA financial statements audit. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state 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.
- 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2004 amounted to approximately \$302,897. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$140,501 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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	\$ 16,671,859	
Deduct:		
Bonds Payable	(4,740,000)	
Notes Payable	<u>(785,000)</u>	\$ 11,146,859
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		3,289,564
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balances	\$ 1,592,404	
Deduct:		
Interest payable	<u>(151,808)</u>	1,440,596
<u>Net assets restricted for other purposes</u>		
Other governmental funds - fund balance restricted for other purposes		296,412
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 1,966,988	
Deduct:		
Bond and Notes	(1,285,000)	
Compensated absences debt	(876,620)	
Treasury Department - Social Security debt	(71,955)	
Advance property taxes debt	<u>(1,196,115)</u>	<u>(1,462,702)</u>
Total net assets - governmental activities		<u>\$ 14,710,729</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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 \$1,893,375 in the general fund, \$469,897 in the special revenue fund - local and state grants, \$552,176 in the special revenue fund - federal grants, and \$15,188 in the capital projects fund - local and state grants were fully collateralized at June 30, 2004. In the other governmental funds there were deposits with commercial banks of approximately \$63,385 that were fully collateralized.

The deposits at GDB of approximately \$58,450 in the special revenue fund - local and state grants, \$133,363 in the special revenue fund - federal grants, \$3,851,078 in the capital projects fund - local and state grants that are restricted for other purposes and capital projects, and the \$1,488,362 in the debt service fund 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, 2004, 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, 2004, net of allowance for uncollectibles.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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 property tax collections related to the amnesty granted through the Public Law 74, enacted on March 1, 2004. The amounts receivable from governmental entities are as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ 103,094
Puerto Rico Electric Power Authority ("PREPA")	<u>162,060</u>
Total	<u>\$ 265,154</u>

On September 7, 2004, Act Num. 255 was enacted and a new formula as described in Note 1 (E) (2), was established for the calculation of the contribution in lieu of taxes to be paid to the municipalities by PREPA. Since the final liquidation following such formula was not available for fiscal year 2003-2004, the PREPA issued a preliminary liquidation, which could be affected by final results of the PREPA financial statements audit.

Intergovernmental receivable in special revenue fund - local and state grants represent expenditures incurred not yet reimbursed by the other governmental entities. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Department of Labor	\$ 23,556
"Consortio del Noreste"	<u>81,161</u>
Total	<u>\$ 104,717</u>

Intergovernmental receivable in special revenue fund - federal grants represent expenditures incurred not yet reimbursed by the Federal government or the pass-through grantor. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Community Facilities Loans	\$ 228,000
Community Development Block Grant	439,726
Child Care and Development Block Grant	66,581
Community Service Block Grant	<u>12,153</u>
Total	<u>\$ 746,460</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in the debt service fund represents the amounts due from the CRIM resulting from the excess of current year property tax collections over current year advances. Following is a detail of the intergovernmental receivables:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	<u>\$ 105,847</u>
Total	<u>\$ 105,847</u>

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2004, and interfund transfers during the fiscal year ended at June 30, 2004, 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 – Local and State Grants	Payrolls, accruals, and other expenditures not reimbursed	\$ 286,111
General Fund	Special Revenue Fund – Federal Grants	Payrolls, accruals, and other expenditures not reimbursed	612,308
General Fund	Debt Service Fund	Interest revenue	2,758
General Fund	Other Governmental Funds	Payrolls, accruals, and other expenditures not reimbursed	<u>16,162</u>
Total			<u>\$ 917,339</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund-Local and State Grants	To match special grant funds	\$ 32,353
General Fund	Debt Service Fund	Debt retirement	<u>43,200</u>
Total			<u>\$ 75,553</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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 2004, 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, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2004</u>
Capital asset, not being depreciated:				
Land	\$ 1,825,177	\$ 2,471,736	(\$4,831)	\$ 4,292,082
Construction in progress	<u> </u>	<u>1,915,501</u>		<u>1,915,501</u>
Total capital assets not being depreciated	<u>1,825,177</u>	<u>4,387,237</u>	<u>(4,831)</u>	<u>6,207,583</u>
Capital assets, being depreciated:				
Buildings	11,355,667			11,355,667
Buildings improvements	288,118	8,475		296,593
Infrastructure	8,292	11,919		20,211
Infrastructure improvements	96,023	280,592		376,615
Equipment	1,490,967	103,521		1,594,488
Furnishing	496,284	9,084		505,368
Work of art	400			400
Computers	147,437	33,405		180,842
Vehicles	<u>1,902,330</u>	<u>227,632</u>		<u>2,129,962</u>
Total capital assets being depreciated	<u>15,785,518</u>	<u>674,628</u>	<u> </u>	<u>16,460,146</u>
Less accumulated depreciation for:				
Buildings	(1,957,506)	(283,892)		(2,241,398)
Buildings improvements	(15,206)	(7,319)		(22,525)
Infrastructure	(559)	(381)		(940)
Infrastructure improvements	(864)	(12,253)		(13,117)
Equipment	(1,255,809)	(132,881)		(1,388,690)
Furnishing	(354,444)	(69,577)		(424,021)
Works of art	(43)	(40)		(83)
Computers	(128,614)	(13,856)		(142,470)
Vehicles	<u>(1,663,347)</u>	<u>(99,279)</u>	<u> </u>	<u>(1,762,626)</u>
Total accumulated depreciation	<u>(5,376,392)</u>	<u>(619,478)</u>	<u> </u>	<u>(5,995,870)</u>
Total capital assets being depreciated, net	<u>10,409,126</u>	<u>55,150</u>	<u> </u>	<u>10,464,276</u>
Governmental activities capital assets, net	<u>\$ 12,234,303</u>	<u>\$ 4,442,387</u>	<u>(\$4,831)</u>	<u>\$ 16,671,859</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:	<u>Amount</u>
General government	\$ 363,042
Public safety	20,327
Public works	88,708
Culture and recreation	74,901
Health and welfare	53,179
Community development	19,070
Economic development	<u>251</u>
Total depreciation expense-governmental activities	<u>\$ 619,478</u>

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, 2004

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, 2004, the related unpaid property taxes advances included in the Statement of Net Assets amounted to \$5,699 and payable in the fiscal year 2004-2005.

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 Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The government-wide statement of net assets includes an outstanding balance of \$700,940 and \$489,476 related to Law 146 and the Law 42.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES (CONTINUED)

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. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the general fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM) – Fiscal Year 2003-2004 Liquidation	\$ 96,406
General Services Administration	3,508
Department of Treasury – Income Tax	10,125
Department of Labor – Unemployment	<u>671</u>
Total	<u>\$ 110,710</u>

8. DEFERRED REVENUES

A. Municipal License Tax- The deferred revenues of approximately \$506,750 in the general fund relates to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. DEFERRED REVENUES (CONTINUED)

B. Federal Government- The deferred revenues presented in the special revenue fund – federal grants 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>
Public Assistance Grant	\$ 250,021
Incentive Grant – Department of Transportation	27,897
Emergency Management Performance Grant	12,462
Housing Preservation Grant	718
Nutrition Program for the Elderly	24,053
Title V – Delinquency Prevention Program	1,098
Special Program for Aging Title III	726
Child Care & Development Block Grant	50,316
Hazard Mitigation Grant	<u>4,360</u>
Total	<u>\$ 371,651</u>

The deferred revenues presented in the other governmental funds represent 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	<u>\$ 47,223</u>
Total	<u>\$ 47,223</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2004, 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	\$ 6,255,000	\$ -	\$ 230,000	\$ 6,025,000	\$ 210,000
Notes Payable	821,000	228,000	264,000	785,000	196,000
Property Taxes Advances	1,404,924		208,809	1,196,115	43,416
Treasury Department –					
Social Security	107,955		36,000	71,955	36,000
Compensated Absences	<u>733,373</u>	<u>184,250</u>	<u>41,003</u>	<u>876,620</u>	<u>46,624</u>
Total	<u>\$ 9,322,252</u>	<u>\$ 412,250</u>	<u>\$ 779,812</u>	<u>\$ 8,954,690</u>	<u>\$ 532,040</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. 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, 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. Bonds payable outstanding at June 30, 2004 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, 2004</u>
1993 Series	7-1-12	\$ 2,015,000	5.00% to 8.00%	\$ 1,285,000
2000 Series	7-1-14	460,000	2.70% to 7.81%	385,000
2003 Series	7-1-27	4,430,000	5.00% to 6.50%	<u>4,355,000</u>
Total general obligation bonds				<u>\$ 6,025,000</u>

These bonds 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>
2005	\$ 210,000	\$ 307,715
2006	220,000	379,667
2007	235,000	364,017
2008	255,000	347,072
2009	275,000	328,659
2010-2014	1,505,000	1,320,760
2015-2019	905,000	933,770
2020-2024	1,175,000	605,312
2025-2029	<u>1,245,000</u>	<u>168,837</u>
Total	<u>\$ 6,025,000</u>	<u>\$ 4,755,809</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. 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, 2004</u>
2000 Series	7-1-04	\$ 425,000	2.70% to 7.81%	\$ 100,000
2003 Series	1-1-10	521,000	4.75%	457,000
2004 Series	1-1-11	228,000	4.25%	<u>228,000</u>
Total notes payable				<u>\$ 785,000</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>
2005	\$ 196,000	\$ 32,798
2006	101,000	26,988
2007	105,000	22,330
2008	110,000	17,498
2009	115,000	12,433
2010-2014	<u>158,000</u>	<u>8,743</u>
Total	<u>\$ 785,000</u>	<u>\$ 120,790</u>

- 4. Property Taxes Advances Debt-** These amounts represent the balance owned to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2004, as described in Note 6.
- 5. Treasury Department - Social Security Debt-** These amounts represent the balance owned to the Treasury Department at June 30, 2004 for social security payments issued by the Treasury Department in the past, on behalf of the Municipality.
- 6. Compensated absences-** The government-wide statement of net assets includes approximately \$544,570 of accrued sick leave benefits, and approximately \$332,050 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

10. 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.

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, 2004 amounted to approximately \$193,970 and \$217,410, 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

10. PENSION PLAN (CONTINUED)

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, 2004, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

11. 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.

12. 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's 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, 2004

13. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$3,063 to properly presents the previously reported fund balance at June 30, 2003. The restatement is due to the recognition of interfund receivable.

The beginning Fund Balances for Debt Service Fund has been restated by approximately \$265,847 to properly present the previously reported fund balances at June 30, 2003. The restatement is mainly due to the recognition of the amount due from Municipal Revenue Collection Center ("CRIM") related to Final Liquidation 2002-2003.

The beginning Governmental Activities Net Assets has been restated by approximately \$145,261 to properly present the previously reported net assets at June 30, 2003. The restatement is mainly due to fund balances restatements described above, and the recognition of bond and notes accrued interest as of the beginning of the current fiscal year.

15. SUBSEQUENT EVENTS

On September 7, 2004, Public Law 255 was enacted amending Public Law 83 of May 2, 1941, as amended. In addition to the new formula established for the calculation of the contribution in lieu of taxes as described in Note 1 (E) (2), applicable on fiscal year 2002-2003 and each subsequent fiscal year, the Law provides for quarterly revisions to be prepared by PREPA of its estimates corresponding to the contribution in lieu of taxes for the current fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(NOTES TO BUDGETARY COMPARISON SCHEDULE)**

YEAR ENDED JUNE 30, 2004

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property taxes	\$ 2,237,368	\$ 2,657,905	\$ 2,741,668	\$ 83,763
Municipal license tax	773,850	735,009	777,927	42,918
Licenses, permits and other local taxes	462,000	682,548	707,780	25,232
Charges for service	58,780	19,105	20,361	1,256
Intergovernmental	2,744,670	2,790,198	2,739,049	(51,149)
Rent of property	29,300	21,429	28,241	6,812
Fines and forfeitures	1,100	290	290	
Interest	50,000	174,797	193,473	18,676
Miscellaneous	<u>120,500</u>	<u>302,332</u>	<u>917,504</u>	<u>615,172</u>
Total revenues	<u>6,477,568</u>	<u>7,383,613</u>	<u>8,126,293</u>	<u>742,680</u>
Budget carryover (1)		539,420	539,420	
Total revenues after carryover	<u>6,477,568</u>	<u>7,923,033</u>	<u>8,665,713</u>	<u>742,680</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	3,487,326	4,414,256	4,350,108	64,148
Public safety	97,625	100,456	98,496	1,960
Public works	1,456,061	1,821,763	1,787,317	34,446
Health and welfare	1,123,408	1,172,218	1,163,903	8,315
Culture and recreation	252,351	353,156	352,093	1,063
Economic development	17,597	17,984	16,388	1,596
Operating transfer to other fund	<u>43,200</u>	<u>43,200</u>	<u>43,200</u>	
Total expenditures, encumbrances and other financing uses	<u>6,477,568</u>	<u>7,923,033</u>	<u>7,811,505</u>	<u>111,528</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)				
	<u>\$ _____</u>	<u>\$ _____</u>	<u>\$ 854,208</u>	<u>\$ 854,208</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)*available for appropriation* from the budgetary comparison schedule				\$ 8,665,713
Differences-budget to GAAP:				
Budget Carryover				(539,420)
GAAP adjustment to revenues				<u>(180,863)</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,945,430</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)*total charges to appropriations* from the budgetary comparison schedule				\$ 7,811,505
Differences-budget to GAAP:				
GAAP adjustment to expenditures				(30,178)
Prior year encumbrances recorded as current year expenditures for GAAP basis				183,315
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(462,080)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,502,562</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

YEAR ENDED JUNE 30, 2004

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, 2004 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Program:			
Nutrition Program for the Elderly	10.570		\$ 15,463
Direct Program:			
Community Facilities Loans and Grants	10.766		<u>367,087</u>
Total U.S. Department of Agriculture			<u>382,550</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Section 8 Housing Choice Vouchers	14.871		417,073
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants - State's Program	14.228	03-AB, FC-41 02-AB, FC, FE-41 01-FD-41 00-FD-41 99-FD-41 98-FD-41	<u>834,512</u>
Total U.S. Department of Housing and Urban Development			<u>1,251,585</u>
U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico - Governor's Office (Elderly Office):			
Special Program for Aging - Title III, Part B, Grant for Supportive Services and Senior Centers	93.044	Not Available	87,628

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
Pass-through the Commonwealth of Puerto Rico - Family Department (ACUDEN) Community Service Block Grant	93.569	Not Available	44,238
Pass-through the Commonwealth of Puerto Rico - Family Department (ACUDEN): Child Care and Development Block Grant	93.575	Not Available	<u>361,332</u>
Total U.S. Department of Health and Human Services			<u>493,198</u>
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR): Public Assistance Grants	83.544	1247-DRPR	17,678
Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency: Emergency Management Performance Grants	83.552	Not Available	<u>4,577</u>
Total U.S. Department of Homeland Security			<u>22,255</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 2,149,588</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, 2004

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	\$ 1,732,515	\$ 417,073	\$ 2,149,588
Non federal programs expenditures	15,976	35,299	51,275
Total expenditures in the general purpose financial Statements	<u>\$ 1,748,491</u>	<u>\$ 452,372</u>	<u>\$ 2,200,863</u>



López-Vega, CPA, PSC

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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, 2004, and have issued our report thereon dated January 24, 2005, 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*.

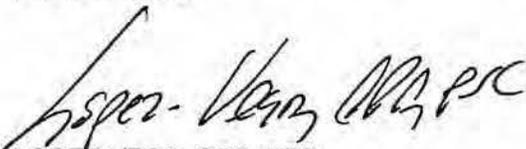
Internal Control Over Financial Reporting

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 item **04-01**.

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 January 24, 2005.

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
January 24, 2005

Stamp No. 2019455 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

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

To the Honorable Mayor
and 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, 2004. 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 04-02 and 04-03 in the accompanying schedule of findings and questioned costs, the **Municipality of Luquillo** did not comply with requirements regarding Cash Management, and Eligibility of Individuals 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, 2004. 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, 04-04 through 04-11.

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.

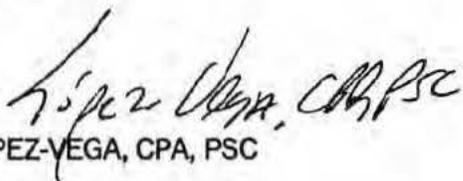
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance 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 04-02 through 04-11.

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 04-02, 04-03, 04-05, 04-09 and 04-11 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 February 25, 2005.



**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
February 25, 2005

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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, 2004

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued: Unqualified

Internal control over financial reporting:

Material weakness identified?	Yes	No <input checked="" type="checkbox"/>
Reportable conditions identified not considered to be material weaknesses?	Yes <input checked="" type="checkbox"/>	None reported

Noncompliance material to financial statements noted? Yes No

Federal awards

Internal Control over major programs:

Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Reportable conditions identified not considered to be material weaknesses?	Yes <input checked="" type="checkbox"/>	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 No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grant – State’s Program
14.871	Section 8 Housing Choice Voucher
93.575	Child Care and Development Block Grant

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

Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II - Financial Statements Findings

Finding Reference	04-01
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 and Corrective Action	The Municipality's Management concurs with the finding. The Finance Department Staff with the assistance of Office of Commissioner Municipal Affairs Staff have updated the accounting system as of June, 2004.

Responsible Person: Annette Caraballo - Finance Director

Implementation Date: January, 2004

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-02
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 \$78,254. At June 30, 2004, the cash balance in book was \$63,385; \$3,495 of these funds was from HUD overpayment during the fiscal year 2003-2004 as determined in the preliminary year-end settlement; \$7,399 was from operating reserve at June 30, 2004; and the remaining \$52,491 was not identified by us with respects to its origin.</p> <p>Also, we noted that during eight (8) months of the fiscal year 2003-2004 the PHA maintained a leasing rate under 95%. In addition, the program maintained an average leasing rate of 93% for the fiscal year.</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> <p>Housing Choice Voucher Program Guidebook, Chapter 24, Section, 24.6 stated that a PHA must lease 95 percent of its units. A PHA with a utilization rate below 95 percent will not be identified as a high performer regardless of its overall score and will not be eligible to receive new unit's allocation.</p>
Cause of Condition	The condition could be caused by cumulative effect of accounting errors in the past years or current years.
Effect of Condition	The PHA did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-02 (continued)

Recommendation We recommend to the Municipality's Management to instruct the program accountant to review the accounting records and related transactions supporting documents for the current and past years in order to identify the cash balance respects to its origin, and later, to make any necessary adjusting journal entries to correct accounting records.

Questioned Costs None

Management Response
and Corrective Action The Municipality's Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

Responsible Person: Nelson Márquez - Federal Program Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-03
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	During our verification of fifteen (15) participant's files we noted that in ten (10) files the program, as part of the Housing Assistance Payment calculation, did not use the lower of the "Payment Standard for the Family" or the "Gross Rent of the Unit". As result, the program paid an incorrect Housing Assistance Payment to the owners and it caused differences in the amount of Tenant Rent paid to the owners or the utility reimbursement to the families.
Criteria	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.
Cause of Condition	The PHA controls and procedures failed to assure that all HAP's payments are duly computed by the program staff.
Effect of Condition	The PHA is not in compliance with Code of Federal Regulations 24, Subpart K, Section 982.505 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 that the PHA must verify the tenant files to determine which families required adjustments in their rents or utility reimbursements, and adjust the same retroactively to the date of the last reexamination, if need.
Questioned Costs	None.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-03 (continued)

Management Response
and Corrective Action

The Municipality's Management concurs with the finding. The Program Director instructed the Program Staff to review and adjust Housing Assistance Payments differences caused by not using the lower of the "Payment Standard for the Family" or the "Gross Rent of the Units"

Responsible Person: Juan P. Rodríguez - Housing Program Technician

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-04
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, 2004. 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 and Corrective Action	The Municipality's Management concurs with the finding. The Federal Program Department Staff is preparing a review of the utility rates for the fiscal year 2004-2005.

Responsible Person: Nilda Figueroa – Administrative Staff
Nelson Márquez – Federal Program Director

Implementation Date: 2004-2005

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Finding and Questioned Cost

Finding Reference	04-05
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 (OCAM)
Requirement	Allowable Activities
Statement of Condition	<p>During our examination of eight (8) housekeeping assistance project participant’s files, we noted the following situations:</p> <ul style="list-style-type: none">a) Three (3) participant’s files did not have copy of the social security of the family members. Also, five (5) participant’s files did not have complete evidence to support medical expenditures of the participant.b) Eight (8) participant’s files did not have evidence of the approval form. (OCAM-AH-004A)c) Eight (8) participant’s files did not have the participation contract between the Municipality and the participant, establishing the service plan to be offered. (OCAM-AH-005)d) In seven (7) cases the Service Coordinator visited approximately one time every two month the participant house to ensure the quality of services. Also, the Service Coordinator did not use the OCAM-AH-006 when visited the participant housing unit.
Criteria	Code of Federal Regulations 24, Section 570.484 states that the Municipality must assure that the program funds benefit very low, low- and moderate income persons and retain documentation justifying its certification. Also, the Office of the Commissioner of Municipal Affairs (“OCAM”) issued a procedures manual for housekeeper activities titled “Guía Operacional para el Servicio de Auxiliares del Hogar”.
Cause of Condition	The Municipality controls and procedures failed to assure that the participant’s files include all the required documents to comply with the program requirements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 04-05 (continued)

Effect of Condition The Municipality is not in noncompliance with Code of Federal Regulations 24, Section 570.484 and with procedures manual issued by the Office of the Commissioner of Municipal Affairs (“OCAM”).

Recommendation We recommended management to follow the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures guide title “Guia Operacional para el Servicio de Auxiliaries del Hogar”, including the use of the forms included on it.

Questioned Costs None

Management Response
and Corrective Action

The Municipality’s Management concurs with the finding. The Federal Program Director will give instructions to the Program Coordinator to follow the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures guide title “Guia operacional para la prestación del servicio de Auxiliares en el Hogar”, including the use of the forms included on it.

Responsible Person: Nilda Figueroa – Housekeeping Program
Coordinator

Implementation Date: August, 2004

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-06
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 (OCAM)
Requirement	Davis-Bacon Act
Statement of Condition	During our Davis-Bacon Act test, for the Community Development Block Grant Program – State’s Program, we verified the construction projects 00-FD-41-007. We noted that the Municipality did not monitor the weekly payrolls submitted by the contractor to assure the compliance with prevailing wage rates.
Criteria	Davis-Bacon Act, as amended, DOL (40 USC 276a – 276a-7).
Cause of Condition	The Municipality’s internal controls failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
Effect of Condition	The Municipality is not in compliance with Davis-Bacon Act, as amended, DOL (40 USC 276a -276a-7).
Recommendation	We recommend management to 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 extent of violations, if any, and then communicate promptly to the contractors any failure in the payroll process.
Questioned Costs	None
Management Response and Corrective Action	The Municipality’s Management concurs with the finding. The Federal Program Inspector will monitor the weekly payrolls submitted by the contractor to assure the compliance with prevailing Responsible Person: Cecilio Medina - Inspector Implementation Date: April, 2005

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-07
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 (OCAM)
Requirement	Procurement and Suspension and Debarment
Statement of Condition	<p>During our contract provision test we verified three (3) contracts for the Community Development Block Grants – State’s Program formalized during the fiscal year 2003-2004. The following summarizes the situations found:</p> <ul style="list-style-type: none">a. Two (2) contracts did not include a provision for compliance with the Clean Air Act and Water Act.b. Three (3) contracts did not include a provision for compliance with Energy Policy and Conservation Act.c. One (1) contract did not include provisions for retention of all required records for three years.
Criteria	Code of Federal Regulations 24, Subpart I, Section 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality’s internal control and procedures failed to detect the exclusion of certain contract clauses in the procurement process.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Section 570.489 (g).
Recommendation	We recommend that the Municipality should strengthen its procedures in order to assure that the contracts contain all provisions requested by federal agencies.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-07 (continued)

Management Response
and Corrective Action

The Municipality's Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

Responsible Person: Nelson Márquez – Federal Program Director

Implementation Date: April, 2005

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-08

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 (OCAM)

Requirement Reporting

Statement of Condition Our examination of the reporting requirements of the Community Development Block Grant – State’s Program revealed the following:

- a. We verified the Financial Quarterly Report ended on March 31, 2004. 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 Disbursements Accounting Number	Amount per Quarterly Report	Amount per General Ledger	Difference
99-FD-005 (601)	\$ 85,995.10	\$ 88,058.30	(\$ 2,063.20)
00-FD-006 (510)	61,200.00	39,550.00	21,650.00
00-FD-ADM (706)	2,991.77	2,704.52	287.25
03-AB-ADM (92.25)	260.78	449.17	(188.39)

- b. Three (3) of the Financial Quarterly Reports for the fiscal year 2003-2004 were submitted to the Office of Commissioner of Municipal Affairs after the deadline.
- c. Program year reports 2002, 2000 and 1994, included as part of the Financial Quarterly Report ended on March 31, 2004, have mathematical differences in the total column.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-08 (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 March 31, 2004.
Recommendation	We recommend to the Municipality's Management to reconcile differences between the financial quarterly report and the general ledgers before report submission to the pass-through grantor. Also, we recommend that the Municipality should strengthen it's procedures in order to assure that all financial and programmatic reports are submitted on time to agencies.
Questioned Costs	None
Management Response and Corrective Action	The Municipality's Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

Responsible Person: Nelson Márquez - Federal Program Director

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-09
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico - Family Department (ACUDEN)
Requirement	Allowable Cost - Cost principles
Statement of Condition	<p>During our disbursements test of the Child Care and Development Block Grant Program we examined fifteen (15) disbursement vouchers of the Regular Grant "Red De Cuido" and two (2) disbursement vouchers of the Summer 2003 Grant and we noted the following situations:</p> <ul style="list-style-type: none">a. On fifteen (15) disbursement vouchers the Municipality did not cancelled or marked as paid the documents along the disbursements voucher.b. On one (1) disbursement vouchers there was no evidence of the original invoice.c. On two (2) disbursement vouchers there was no evidence of the receiving report or the certification of the Municipality's employee who receive of the good or services.d. On four (4) disbursement vouchers the Purchase Order was issued after the receiving of goods or services.e. Nine (9) cancelled checks were not available for our examination.
Criteria	Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (6) states that accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub grant award documents and others.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-09 (continued)
Cause of Condition	The Municipality controls and procedures failed to assure that all disbursements made have all 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	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (6), provisions regarding allowable cost.
Recommendation	We recommend that the Municipality should strengthen its procedures to assure that all disbursement transactions 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 strengthen its record retention system to assure that all documents related to the federal grants were properly maintained.
Questioned Cost	None
Management Response and Corrective Action	The Municipality's Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

Responsible Person: Samayra Filomeno – Program Accountant

Implementation Date: April, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-10
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico – Family Department (ACUDEN)
Requirement	Eligibility
Statement of Condition	During our verification of fifteen (15) participant's files we noted that for seven (7) participants the Municipality miscomputed the monthly gross income or the monthly deductions as part of the eligibility determination. As result, in six (6) cases the parent contribution was incorrect.
Criteria	Code of Federal Regulations 45, Subpart C, Section 98.20 states that in order to be eligible for services, a child shall: (1) be under 13 years of age or be under age 19 and physically or mentally incapable of caring for himself or herself or under court supervision; (2) reside with a family whose income does not exceed 85% of the State's median income for a family of the same size; (3) reside with a parent or parents who are working or attending a job training or educational program or receives protective services. Also, the pass through agency promulgates controls and procedures to be used by the Municipality in the eligibility determination process.
Cause of Condition	The Municipality's internal controls and procedures failed to assure that the eligibility and the parent's contribution were determined using the correct income and deductions amounts.
Effect of Condition	This caused that the Municipality receive incorrect amounts of parent's contribution.
Recommendation	We recommend the Municipality to assure that the participant's eligibility and the parents contributions determination are performed using the procedures established by the federal and local agencies.
Questioned Costs	None.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-10 (continued)

Management Response
and Corrective Action

The Municipality's Management concurs with the finding. The Program Coordinator will review the participant's files and will recalculate the parent contribution. As part of the corrective actions to be taken the Program Coordinator will perform the calculations from now on.

Responsible Person: Edhilma Figueroa - Program Coordinator

Implementation Date: March, 2005

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-11
Program	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Family Department (ACUDEN)
Requirement	Reporting
Statement of Condition	During our reporting test we noted the following situations: a. We did not obtain evidence of the submission by the Municipality of the Equipment Inventory and the Trial Balance as of September 30, 2003 and September 30, 2004, respectively. b. We did not obtain evidence of the submission date of the Annual Closing Report (CC-006) for the program fiscal years ended September 30, 2003 and September 30, 2004.
Criteria	The grant agreement between the Municipality and the pass trough agency specify the financial reports required to the Municipality at the end of each program year. Also, Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1) states that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.
Cause of Condition	The Municipality controls and procedures failed to assure that the financial and programmatic reports were prepared according to Federal and State Regulations and were submitted to the agencies on time.
Effect of Condition	The Municipality is not in compliance with the grant agreement and with the Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1), provisions regarding financial reporting.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-11 (continued)

Recommendation We recommend that the Municipality should implement controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports. Also, we recommend that 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.

Questioned Cost None

Management Response
and Corrective Action The Municipality's Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.

Responsible Person: Edhilma Figueroa – Program Coordinator

Implementation Date: April, 2005

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-04	14.871	<p><u>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.</u></p> <p>Full corrective action has been taken.</p>
03-05	14.871	<p><u>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. 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. 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. 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.</u></p> <p>Full corrective action has been taken.</p>
03-06	14.871	<p><u>In seven (7) participant's files the program used an incorrect utility allowance amount in the Housing Assistance Payment calculation. 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". 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. 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. In one (1) participant's file the PHA did not reexamine a family income and composition reexamination during the fiscal year 2002-2003.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 04-03.</p>
03-07	14.871	<p><u>The PHA maintained during the current fiscal year average cash balance in books of approximately \$45,974. At June 30, 2003, the</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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. Also, 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.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 04-02.</p>
03-08	14.871	<p><u>The PHA did not maintained a waiting list during the fiscal year 2002-2003.</u></p> <p>Full corrective action has been taken.</p>
03-09	14.871	<p><u>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.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 04-04.</p>
03-10	14.871	<p><u>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.</u></p> <p>Full corrective action has been taken.</p>
03-11	14.228	<p><u>Twelve (12) disbursement vouchers were not cancelled or marked as paid along the document. Four (4) disbursement vouchers the disbursement voucher did not include evidence of the Purchase Requisition. 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. On eleven (11) disbursement vouchers the purchase orders were prepared after the receiving of the</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<u>goods or services.</u>
		Full corrective action has been taken.
03-12	14.228	<u>There are differences between the amounts presented in the Financial Quarterly Report and the amounts presented in the program's General Ledger.</u>
		No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 04-08.
02-04	14.228	<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>
		Full corrective action has been taken.
02-11	14.871	<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>
		Full corrective action has been taken.
02-12	14.871	<u>The Program should establish monitoring procedures to assure that the participant's files include all documentation required by federal agencies.</u>
		Full corrective action has been taken.
02-13	14.871	<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>
		No corrective action has been taken. The auditors reissued the finding for the current year. Finding Reference 04-03.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

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>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 04-04.</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>Full corrective action has been taken.</p>