

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE LUQUILLO

AUDITORIA 2004-2005

30 DE JUNIO DE 2005

OFFICE OF THE COMPTROLLER
OF THE COMMONWEALTH OF PUERTO RICO
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SINGLE AUDIT REPORT
YEAR ENDED JUNE 30, 2005

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2005

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López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo, Puerto Rico**, as of and for the year ended June 30, 2005, 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, 2005, 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 12 and the Budgetary Comparison Schedule-General Fund on page 40 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 AUDITOR'S REPORT (CONTINUED)

In accordance with *Government Auditing Standards*, we have also issued our report dated November 10, 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
November 10, 2005

Stamp No. 2106121 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, 2005

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, 2005. 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, 2004, second 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 fiscal year 2004-2005, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess 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 2005 constitute factual evidence of the Municipality's economic strength by the end of such year. The following comments deserve special mention:

1. At the end of fiscal year 2005, total liabilities amounted to \$10,438,113. Out of said amount, \$8,408,254 corresponded to long-term liabilities of which \$6,432,000 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;
2. Total net assets of the Municipality amounted to \$15,894,632 which represents an increase of 8% compared to prior fiscal year;
3. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$11,144,991, derived from the following sources: \$88,773 charges for services; \$2,635,112 from operating grants and contributions; \$320,381 from capital grants and contributions obtained from other sources, and \$8,100,725 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL HIGHLIGHTS (CONTINUED)

4. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$9,850,388;
5. As reflected in the Statement of Activities, the current fiscal year operations contributed to the increase in the Net Assets Figure by \$1,294,603;
6. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$5,916,875;
7. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$1,863,998. 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;
8. In accordance with the aforementioned policy, during fiscal year 2005 the Municipality used \$127,844 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.
9. The actual General Fund budgetary activities resulted in a favorable balance of \$204,920 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.
10. 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 2005 which amounted to \$526,099.

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 2005. 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, 2005

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 on 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 the 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, 2005, shows total expenses incurred to afford the cost of all functions and programs amounted to \$9,850,388. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$3,044,266 was derived from the following sources: \$88,773 charges for services; \$2,635,112 from operating grants and contributions; and \$320,381 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$8,100,725. When such figure is added to the \$3,044,266 previously mentioned, total revenues available for the financing of activities amounted to \$11,144,991. There was an excess of revenues over expenses in the amount of \$1,294,603 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, 2005

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)

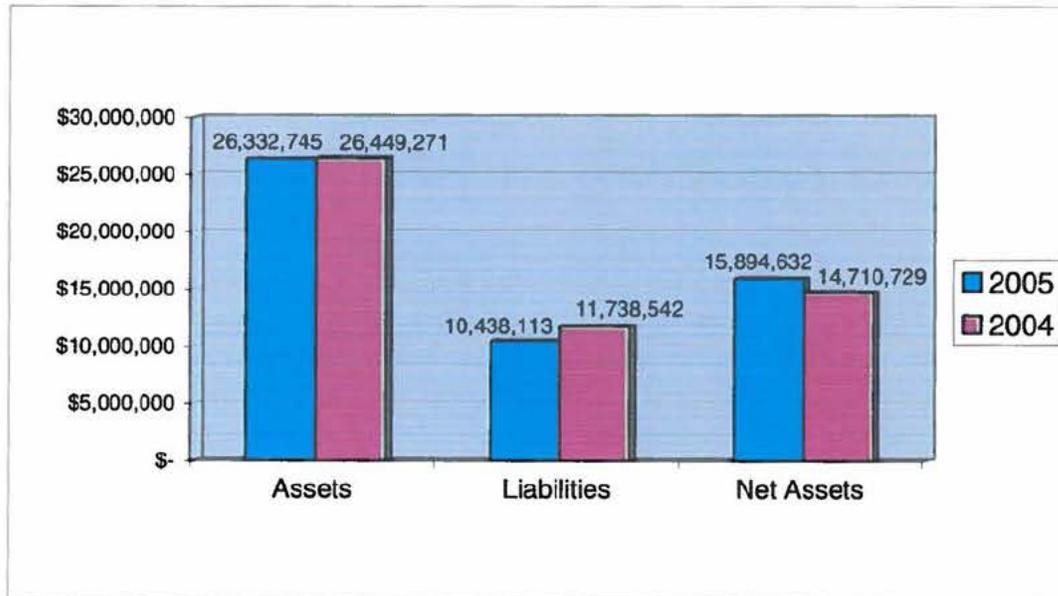
YEAR ENDED JUNE 30, 2005

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 \$15,894,632 at the end of 2005, compared to \$14,710,729 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	2005	2004	Change	%
Current and other assets	\$ 7,538,865	\$ 9,777,412	\$ (2,238,547)	(23%)
Capital assets	18,793,880	16,671,859	2,122,021	13%
Total assets	26,332,745	26,449,271	(116,526)	-
Current and other liabilities	2,029,859	2,783,852	(753,993)	(27%)
Long-term liabilities	8,408,254	8,954,690	(546,436)	(6%)
Total liabilities	10,438,113	11,738,542	(1,300,429)	(11%)
Invested in capital assets, net of related debt	13,541,880	11,146,859	2,395,021	21%
Restricted	3,909,044	5,026,572	(1,117,528)	(22%)
Unrestricted deficit	(1,556,292)	(1,462,702)	(93,590)	6%
Total net assets	\$ 15,894,632	\$ 14,710,729	\$ 1,183,903	8%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2005

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2005, the net effect of the revenues derived from several programs plus current operating revenues, amounted to \$1,294,603. Approximately 50 percent of the Municipality's total revenues resulted from grants and contributions, including federal aid, while 47 percent came from taxes. The largest expenses were for general government, public works, health and welfare, culture and recreation, and public safety. 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.

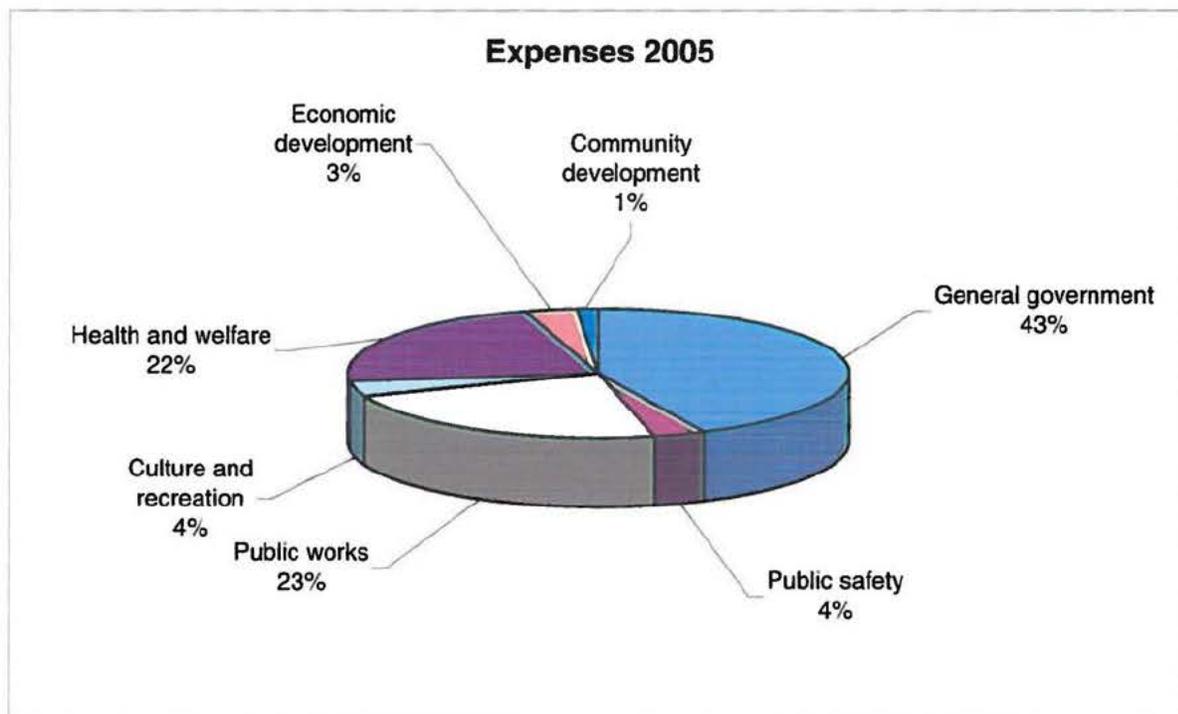
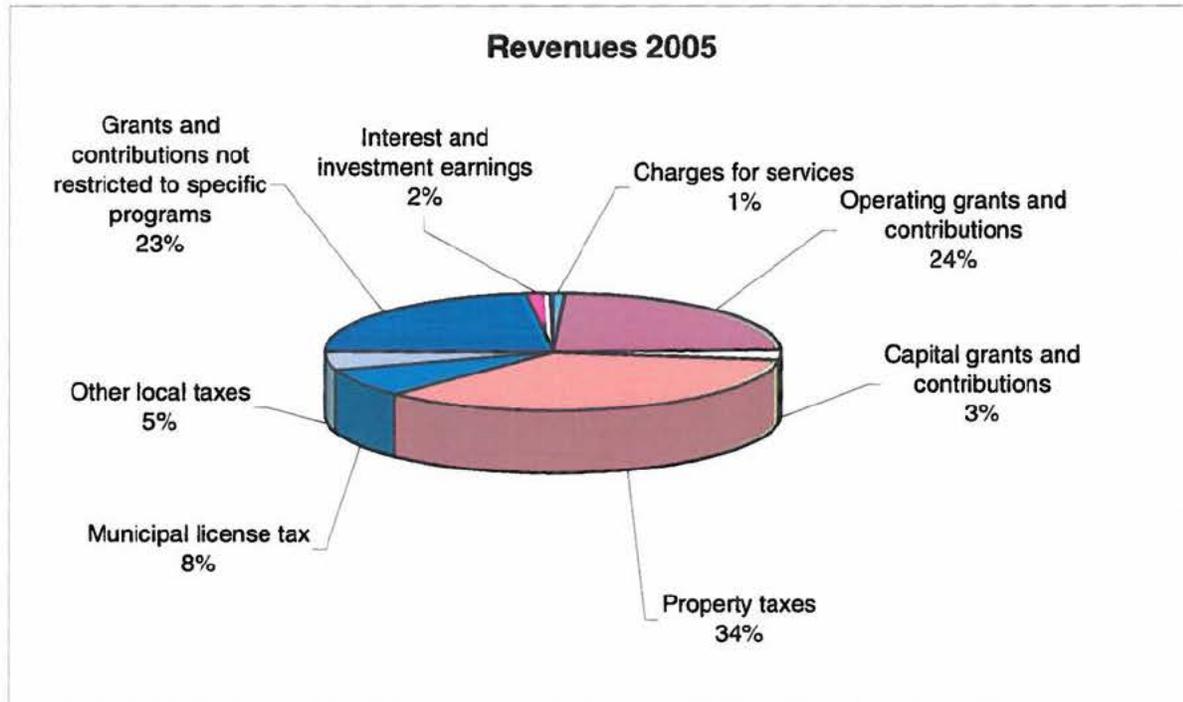
Condensed Statement of Activities	2005	2004	Change	%
Program revenues:				
Charges for services	\$ 88,773	\$ 63,287	\$ 25,486	40%
Operating grants and contributions	2,635,112	2,513,056	122,056	5%
Capital grants and contributions	320,381	2,536,506	(2,216,125)	(87%)
General revenues:				
Property taxes	3,875,754	3,722,173	153,581	4%
Municipal license tax	893,301	789,502	103,799	13%
Other local taxes	583,202	699,266	(116,064)	(17%)
Grants and contributions not restricted to specific programs	2,536,469	3,054,553	(518,084)	(17%)
Interest and investment earnings	183,551	193,473	(9,922)	(5%)
Gain (loss) on sale of capital assets		5,747	(5,747)	(100%)
Miscellaneous	28,448	46,329	(17,881)	(39%)
Total revenues	11,144,991	13,623,892	(2,478,901)	(18%)
Expenses:				
General government	4,098,810	4,419,076	(320,266)	(7%)
Public safety	336,072	237,037	99,035	42%
Public works	2,150,535	722,194	1,428,341	198%
Culture and recreation	389,459	2,162,118	(1,772,659)	(82%)
Health and welfare	2,108,142	1,442,732	665,410	46%
Economic development	317,224	290,627	26,597	9%
Community development	131,369	84,362	47,007	56%
Education	3,034	-	3,034	100%
Interest on long-term debt	315,743	307,165	8,578	3%
Total expenses	9,850,388	9,665,311	185,077	2%
Change in net assets	1,294,603	3,958,581	(2,663,978)	(67%)
Net assets, beginning of year, as restated	14,600,029	10,641,448	3,958,581	37%
Net assets, end of year	\$ 15,894,632	\$ 14,600,029	\$ 1,294,603	9%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

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, 2005

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 \$5,916,875, a decrease of \$1,228,493 in comparison with the prior year. There are reservations of fund balance amounting to \$4,556,273. 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 (\$503,396), 2) to pay debt service (\$1,608,177), 3) to pay for capital projects (\$2,062,019) and 4) for other purposes (\$382,681).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2005, the general fund has an undesignated fund balance of \$1,360,602.

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 2005 the Municipality used \$127,844 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 2005 which amounted to \$526,099. 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, 2005

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2005, amounts to \$25,410,320, net of accumulated depreciation of \$6,616,440 (including \$637,031 of current year depreciation expense), leaving a net book value of \$18,793,880. 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, 2005, the Municipality has \$2,290,526 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").

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2005

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 2005-2006.

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.

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 2005. 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, 2005

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 2,778,934
Cash with fiscal agent	3,952,327
Accounts receivable:	
Municipal license tax	21,233
Construction Tax	12,975
Intergovernmental	758,634
Interest	11,323
Prepaid Expenses	3,439
Capital assets	
Land, improvements, and construction in progress	6,987,874
Other capital assets, net of depreciation	11,806,006
Total capital assets	18,793,880
 Total assets	 26,332,745
 Liabilities	
Accounts payable and accrued liabilities	843,295
Due to other governmental entities	140,939
Interest payable	143,833
Deferred revenues:	
Municipal license tax	580,813
Federal grant revenues	320,979
Noncurrent liabilities:	
Due within one year	377,768
Due in more than one year	8,030,486
Total liabilities	10,438,113
 Net Assets	
Invested in capital assets, net of related debt	13,541,880
Restricted for:	
Capital projects	2,062,019
Debt service	1,464,344
Other purposes	382,681
Unrestricted (deficit)	(1,556,292)
 Total net assets	 \$ 15,894,632

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, 2005**

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	\$ 4,098,810	\$ -	\$ 114,482	\$ -	\$ (3,984,328)
Public safety	336,072	4,091	63,213		(268,768)
Public works	2,150,535	22,451	337,038	310,381	(1,480,665)
Health and welfare	2,108,142	31,031	838,486	10,000	(1,228,625)
Culture and recreation	389,459	20,205	52,049		(317,205)
Economic development	317,224	10,995	302,120		(4,109)
Community development	131,369		925,224		793,855
Education	3,034		2,500		(534)
Interest on long-term debt	315,743				(315,743)
Total governmental activities	\$ 9,850,388	\$ 88,773	\$ 2,635,112	\$ 320,381	(6,806,122)
General revenues:					
Property taxes					3,875,754
Municipal license tax					893,301
Other local taxes					583,202
Grants and contributions not restricted to specific programs					2,536,469
Interest and investment earnings					183,551
Miscellaneous					28,448
Total general revenues					8,100,725
Change in net assets					1,294,603
Net assets - beginning, as restated					14,600,029
Net assets - ending					\$ 15,894,632

Commonwealth of Puerto Rico
Municipality of Luquillo
Balance Sheet
Governmental Funds
June 30, 2005

	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
Assets							
Cash and cash equivalents	\$ 1,821,940	\$ 387,278	\$ 469,896	\$ 24,157	\$ -	\$ 75,663	\$ 2,778,934
Cash with fiscal agent		11,121	187,185	2,290,526	1,463,495		3,952,327
Accounts receivable:							
Municipal license tax	21,233						21,233
Intergovernmental	43,653	305,520	259,620		149,841		758,634
Construction Taxes	12,975						12,975
Interest	8,519				2,804		11,323
Prepaid Expenses	3,439						3,439
Due from other funds	985,567						985,567
Total assets	\$ 2,897,326	\$ 703,919	\$ 916,701	\$ 2,314,683	\$ 1,616,140	\$ 75,663	\$ 8,524,432
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities	\$ 311,576	\$ 10,939	\$ 4,080	\$ 252,664	\$ -	\$ -	\$ 579,259
Due to other governmental entities	140,939						140,939
Due to other funds		311,299	650,281		7,963	16,024	985,567
Deferred revenues:							
Municipal license tax	580,813						580,813
Federal grant revenues			261,340			59,639	320,979
Total liabilities	1,033,328	322,238	915,701	252,664	7,963	75,663	2,607,557
Fund balances:							
Reserved for:							
Encumbrances	503,396						503,396
Capital projects				2,062,019			2,062,019
Other purposes		381,681	1,000				382,681
Debt service					1,608,177		1,608,177
Unreserved:							
Undesigned	1,360,602						1,360,602
Total fund balances	1,863,998	381,681	1,000	2,062,019	1,608,177	-	5,916,875
Total liabilities and fund balances	\$ 2,897,326	\$ 703,919	\$ 916,701	\$ 2,314,683	\$ 1,616,140	\$ 75,663	

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	18,793,880
Long-term liabilities, including non current accounts payable and accrued interests payable, are not due and payable in the current period, and therefore, are not reported in the funds	(8,816,123)
Net assets of governmental activities	\$ 15,894,632

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2005

	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	\$ 3,166,237	\$ -	\$ -	\$ -	\$ 709,516	\$ -	\$ 3,875,753
Municipal license taxes	893,301						893,301
Licenses, permits and other local taxes	583,202						583,202
Charges for services	39,583						39,583
Intergovernmental	2,650,951	600,616	31,294	290,525			3,573,386
Rent of property	31,164						31,164
Fines and forfeitures	4,091						4,091
Interest	183,551					30,079.00	183,551
Federal grants			1,433,064			425,028	1,858,092
Miscellaneous	24,147	4,735	14,017	34		30,079	73,012
Total revenues	7,576,227	605,351	1,478,375	290,559	709,516	485,186	11,115,135
Expenditures							
Current:							
General government	4,234,494	45		40,373			4,274,912
Public safety	195,181	62,776	78,527				336,484
Public works	1,694,460	59,600	129,538	518,881			2,402,479
Health and welfare	1,216,008	10,229	385,095	11,041		455,107	2,077,480
Culture and recreation	322,915	42,398		947,809			1,313,122
Economic development	16,159	300,990					317,149
Community development			925,225				925,225
Education		3,034					3,034
Principal					378,000		378,000
Interest					315,743		315,743
Total expenditures	7,679,217	479,072	1,518,385	1,518,104	693,743	455,107	12,343,628
Excess (deficiency) of revenues over (under) expenditures	(102,990)	126,279	(40,010)	(1,227,545)	15,773	30,079	(1,228,493)
Other financing sources (uses)							
Transfers in							
Transfers out							
Long-term debt issued							
Total other financing sources (uses)							
Net change in fund balances	(102,990)	126,279	(40,010)	(1,227,545)	15,773	30,079	(1,228,493)
Fund balance, beginning	2,866,988	255,402	41,010	3,289,564	1,592,404		7,145,368
Fund balance, ending	2,763,998	\$ 381,681	\$ 1,000	\$ 2,062,019	\$ 1,608,177	\$ 30,079	\$ 5,916,875

*Original
04/07/2005*

**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, 2005**

Net Change in Fund Balances - Total Governmental Funds **\$ (1,228,493)**

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. 2,869,842

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. (637,031)

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. (90)

Interest Payable 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 Payable was not reported as expenditures in Governmental Funds. The following amount represents the change in accrued interest from prior year. 7,975

Accounts Payable reported in the Government-Wide Statement of Activities and Change in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. This is the amount reported in the current period. (264,036)

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 paid in the current period. 378,000

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 change in the social security debt during the fiscal year. 71,955

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 change in the property tax advance debt in the current period. 85,883

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. 10,598

Change in Net Assets of Governmental Activities **\$ 1,294,603**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

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 and 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, 2002. 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, 2005

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

The following is a summary of the significant accounting policies of the Municipality:

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, 2005

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 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 – is the accounting entity in which revenues derived from local funds, state or other restricted revenue source is accounted for the uses and limitations 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 and state 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, 2005

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

Special Revenue Fund – Section 8 – Special Revenue Funds are used to account for revenues derived from Section 8 Housing 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 Fund – 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, 2005

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, 2005

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 allowance for uncollectible accounts, which are determined, based upon past collections experience and current economic conditions. Intergovernmental receivables in the General Fund represent mostly charge for services rendered to other governmental entities. 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

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.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (CRIM) for the year ended June 30, 2005 amounted to approximately \$264,263. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$183,388 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-wide and Fund Financial Statements

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

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 18,793,880	
Deduct:		
Bonds Payable	(4,635,000)	
Notes Payable	<u>(617,000)</u>	\$ 13,541,880
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		2,062,019
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balances	\$ 1,608,177	
Deduct:		
Interest payable	<u>(143,833)</u>	1,464,344
<u>Net assets restricted for other purposes</u>		
Other governmental funds - fund balance restricted for other purposes		382,681
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 1,863,998	
Deduct:		
Accounts Payable	(264,036)	
Bond and Notes Payable	(1,180,000)	
Compensated absences debt	(866,022)	
Advance property taxes debt	<u>(1,110,232)</u>	<u>(1,556,292)</u>
Total net assets - governmental activities		<u>\$ 15,894,632</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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 \$1,821,940 in the General Fund, the \$387,278 in the Special Revenue Fund - Local and State Grants, the \$469,896 in the Special Revenue Fund - Federal Grants, and the \$24,157 in the Capital Projects Fund - Local and State grants were fully collateralized at June 30, 2005. In the Other Governmental Funds there were deposits with commercial banks of approximately \$75,663 that were fully collateralized.

The deposits at GDB of approximately \$11,121 in the Special Revenue Fund - Local and State Grants, the \$187,185 in the Special Revenue Fund - Federal Grants, the \$2,290,526 in the Capital Projects Fund - Local and State Grants that are restricted principally for capital projects, and the \$1,463,495 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 imposes 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 Act 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 15 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, 2005, 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 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2005, net of allowance for uncollectibles.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

3. RECEIVABLES (CONTINUED)

B. *Intergovernmental Receivables* - Intergovernmental receivables in the General Fund consist of the amounts due from the Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico resulting from the excess of current year property tax collections over current year advances. The amount receivable from governmental entities are as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM)	\$ 43,653
Total	<u>\$ 43,653</u>

Intergovernmental receivables in the 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 receivables:

<u>Governmental Entity</u>	<u>Amount</u>
Commonwealth of Puerto Rico - Legislature	\$ 207,500
Department of Labor and Human Resources	<u>98,020</u>
Total	<u>\$ 305,520</u>

Intergovernmental receivables in the 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 receivables:

<u>Program Description</u>	<u>Amount</u>
Community Facilities Loans and Grants	\$ 228,000
Special Program for Aging, Title III	13,585
Community Development Block Grants - State's Program	9,045
Child Care and Development Block Grant	<u>8,990</u>
Total	<u>\$ 259,620</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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 receivable:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center (CRIM)	\$ 149,841
Total	<u>\$ 149,841</u>

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2005 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	\$ 311,299
General Fund	Special Revenue Fund – Federal Grants	Payrolls, accruals, and other expenditures not reimbursed	650,281
General Fund	Debt Service Fund	Interest not transferred	7,963
General Fund	Other Governmental Funds	Payrolls, accruals, and other expenditures not reimbursed	<u>16,024</u>
Total			<u>\$ 985,567</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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 2005, 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, 2004</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2005</u>
Capital asset, not being depreciated:				
Land	\$ 4,292,082	\$ 25,720	\$ -	\$ 4,317,802
Construction in progress	<u>1,915,501</u>	<u>1,616,914</u>	<u>(862,343)</u>	<u>2,670,072</u>
Total capital assets not being depreciated	<u>6,207,583</u>	<u>1,642,634</u>	<u>(862,343)</u>	<u>6,987,874</u>
Capital assets, being depreciated:				
Buildings	11,355,667			11,355,667
Buildings improvements	296,594	1,106,002		1,402,596
Infrastructure	20,210	9,287		29,497
Infrastructure improvements	376,615	684,960		1,061,575
Equipment	1,594,488	118,470	(7,897)	1,705,061
Furnishing	505,369	14,270	(1,803)	517,836
Work of art	400			400
Computers	180,842	45,862	(6,851)	219,853
Vehicles	<u>2,129,961</u>	<u>-</u>	<u>-</u>	<u>2,129,961</u>
Total capital assets being depreciated	<u>16,460,146</u>	<u>1,978,851</u>	<u>(16,551)</u>	<u>18,422,446</u>
Less accumulated depreciation for:				
Buildings	(2,241,398)	(283,892)		(2,525,290)
Buildings improvements	(22,526)	(30,946)		(53,472)
Infrastructure	(940)	(505)		(1,445)
Infrastructure improvements	(13,116)	(50,461)		(63,577)
Equipment	(1,388,690)	(84,019)	7,897	(1,464,812)
Furnishing	(424,021)	(48,523)	1,713	(470,831)
Works of art	(83)	(40)		(123)
Computers	(142,471)	(28,276)	6,851	(163,896)
Vehicles	<u>(1,762,625)</u>	<u>(110,369)</u>	<u>-</u>	<u>(1,872,994)</u>
Total accumulated depreciation	<u>(5,995,870)</u>	<u>(637,031)</u>	<u>16,461</u>	<u>(6,616,440)</u>
Total capital assets being depreciated, net	<u>10,464,276</u>	<u>1,341,820</u>	<u>(90)</u>	<u>11,806,006</u>
Governmental activities capital assets, net	<u>\$ 16,671,859</u>	<u>\$ 2,984,454</u>	<u>(\$ 862,433)</u>	<u>\$ 18,793,880</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:	<u>Amount</u>
General government	\$ 301,807
Public works	125,747
Culture and recreation	84,628
Community development	59,354
Health and welfare	43,241
Public safety	21,786
Economic development	<u>468</u>
Total depreciation expense-governmental activities	<u>\$ 637,031</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 Municipal Revenue Collection Center (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, 2005

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, 2005, the related unpaid property taxes advances included in the Statement of Net Assets amounted to \$4,749.

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, 2003, 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 \$404,543 related to Law 146 and the Law 42, respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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 8.83% for real property and 6.83% 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) 2.00% 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
Department of Labor - Unemployment	20,350
Department of Treasury - Income Tax	19,025
General Services Administration	<u>5,158</u>
Total	<u>\$ 140,939</u>

8. DEFERRED REVENUES

A. Municipal License Tax - The deferred revenues of approximately \$580,813 in the General Fund relates to municipal license tax collected in fiscal year 2004-05 that will be earned in fiscal year 2005-06.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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	\$ 183,105
Child Care and Development Block Grant	50,362
Emergency Management Performance Grant	16,511
Nutrition Program for the Elderly	4,331
Incentive Grant – Department of Transportation	3,253
Community Service Block Grant	1,920
Title V – Delinquency Prevention Program	1,140
Housing Preservation Grant	<u>718</u>
Total	<u>\$ 261,340</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 Housing Choice Voucher Program	<u>\$ 59,639</u>
Total	<u>\$ 59,639</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2005, 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	\$ 6,025,000	\$ -	\$ 210,000	\$ 5,815,000	\$ 220,000
Notes Payable	785,000		168,000	617,000	99,000
Property Taxes Advances	1,196,115		85,883	1,110,232	950
Treasury Department – Social Security	71,955		71,955		
Compensated Absences	<u>876,620</u>	<u>28,198</u>	<u>38,796</u>	<u>866,022</u>	<u>57,818</u>
Total	<u>\$ 8,954,690</u>	<u>\$ 28,198</u>	<u>\$ 574,634</u>	<u>\$ 8,408,254</u>	<u>\$ 377,768</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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, 2005 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, 2005</u>
1993 Series	7-1-12	\$ 2,015,000	5.00% to 8.00%	\$ 1,180,000
2000 Series	7-1-14	460,000	2.70% to 7.81%	360,000
2003 Series	7-1-27	4,430,000	5.00% to 6.50%	<u>4,275,000</u>
Total general obligation bonds				<u>\$ 5,815,000</u>

These bonds are payable from the ad valorem property tax of 2.00% 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>
2006	\$ 220,000	\$ 329,904
2007	235,000	364,017
2008	255,000	347,072
2009	275,000	328,659
2010	295,000	308,772
2011-2015	1,410,000	1,221,170
2016-2020	910,000	875,225
2021-2025	1,250,000	526,500
2026-2030	<u>965,000</u>	<u>97,013</u>
Total	<u>\$ 5,815,000</u>	<u>\$ 4,398,332</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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. Notes payable outstanding at June 30, 2005 are 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, 2005</u>
2003 Series	1-1-10	\$ 521,000	4.75%	\$ 389,000
2004 Series	1-1-12	228,000	4.25%	<u>228,000</u>
Total notes payable				<u>\$ 617,000</u>

The notes are payable from the ad valorem property tax of 2.00% 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>
2006	\$ 99,000	\$ 28,168
2007	104,000	23,605
2008	109,000	18,815
2009	113,000	13,793
2010	119,000	8,585
2011-2015	<u>73,000</u>	<u>4,717</u>
Total	<u>\$ 617,000</u>	<u>\$ 97,683</u>

- 4. Property Taxes Advances Debt** – These amounts represent the balance owed to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2005, as described in Note 6.
- 5. Compensated absences** – The government-wide statement of net assets includes approximately \$448,270 of accrued sick leave benefits, and approximately \$417,752 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, 2005

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, 2005 amounted to approximately \$237,490 and \$266,190, 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, 2005

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, 2005, 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 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, 2005

13. BEGINNING GOVERNMENTAL ACTIVITIES NET ASSETS RESTATEMENT

The beginning Governmental Activities Net Assets has been restated by approximately \$110,700 to properly present the previously reported net assets at June 30, 2004. The restatement is mainly due to changes in the beginning Capital Assets balances.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

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

YEAR ENDED JUNE 30, 2005

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u> <u>(Budgetary Basis)</u>	<u>Variance with</u> <u>Final Budget</u>
	<u>Original</u>	<u>Final</u>	<u>(See Note 1)</u>	<u>Positive</u> <u>(Negative)</u>
REVENUES:				
Property taxes	\$ 2,978,238	\$ 3,314,843	\$ 3,242,528	(\$ 72,315)
Municipal license tax	778,370	869,010	883,643	14,633
Licenses, permits and other local taxes	537,000	591,088	570,227	(20,861)
Charges for service	58,780	39,469	39,582	113
Intergovernmental	2,619,159	2,636,641	2,650,951	14,310
Rent of property	33,000	27,459	31,164	3,705
Fines and forfeitures	3,000	4,091	4,091	-
Interest	115,000	178,047	169,827	(8,220)
Miscellaneous	<u>20,000</u>	<u>7,998</u>	<u>7,297</u>	<u>(701)</u>
Total revenues	<u>7,142,547</u>	<u>7,668,646</u>	<u>7,599,310</u>	<u>(69,336)</u>
Budget carryover (1)	<u>-</u>	<u>127,844</u>	<u>127,844</u>	<u>-</u>
Total revenues after carryover	<u>7,142,547</u>	<u>7,796,490</u>	<u>7,727,154</u>	<u>(69,336)</u>
EXPENDITURES, ENCUMBRANCES:				
Current:				
General government	3,975,280	4,368,112	4,177,196	190,916
Public safety	190,050	209,939	196,112	13,827
Public works	1,500,342	1,668,119	1,641,032	27,087
Health and welfare	1,218,212	1,213,926	1,190,574	23,352
Culture and recreation	239,663	320,294	302,836	17,458
Economic development	19,000	16,100	14,484	1,616
Operating transfer to other fund				
Total expenditures, encumbrances and other financing uses	<u>7,142,547</u>	<u>7,796,490</u>	<u>7,522,234</u>	<u>274,256</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 204,920</u>	<u>\$ 204,920</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 7,727,154
Differences-budget to GAAP:				
Budget carryover				(127,844)
GAAP adjustment to revenues				<u>(23,083)</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,576,227</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 7,522,234
Differences-budget to GAAP:				
GAAP adjustment to expenditures				23,694
Prior year encumbrances recorded as current year expenditures for GAAP basis				426,362
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(293,073)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 7,679,217</u>

(1) Represents fund balance carried over from prior years

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2005

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, 2005 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2005.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Program: Nutrition Program for the Elderly	10.570		\$ 32,000
Direct Program: Community Facilities Loans and Grants	10.766		<u>40,010</u>
Total U.S. Department of Agriculture			<u>72,010</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Section 8 Housing Choice Vouchers	14.871		425,028
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs: Community Development Block Grants - State's Program	14.228	04-AB, FC-41 03-AB, FC-41 02-AB, FC, FE-41 01-FD-41 00-FD-41 99-FD-41 98-FD-41	<u>925,225</u>
Total U.S. Department of Housing and Urban Development			<u>1,350,253</u>
U.S. DEPARTMENT OF TRANSPORTATION:			
Pass-through the Commonwealth of Puerto Rico - Transit Safety Commission Safety Community Project Implementation - Incentive Grant	20.601	Not Available	<u>38,517</u>
Total U.S. Department of Transportation			<u>38,517</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
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	117,277
Pass-through the Commonwealth of Puerto Rico – Family Department (ACUDEN) Community Service Block Grant	93.569	Not Available	9,146
Pass-through the Commonwealth of Puerto Rico – Family Department (ACUDEN): Child Care and Development Block Grant	93.575	Not Available	<u>212,656</u>
Total U.S. Department of Health and Human Services			<u>339,079</u>
U.S DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico – Governor Authorized Representative (GAR): Public Assistance Grants	97.036	1247-DR-PR 1552-DR-PR	93,883
Pass-through the Commonwealth of Puerto Rico – Governor Authorized Representative (GAR): Hazard Mitigation Grant	97.039	Not Available	<u>4,360</u>
Total U.S. Department of Homeland Security			<u>98,243</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 1,898,102</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, 2005

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	\$ 1,473,074	\$ 425,028	\$ 1,898,102
Non federal programs expenditures	45,311	30,079	75,390
Total expenditures in the general purpose financial Statements	<u>\$ 1,518,385</u>	<u>\$ 455,107</u>	<u>\$ 1,973,492</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, 2005, and have issued our report thereon dated November 10, 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 items **05-01** and **05-02**.

**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 November 10, 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
November 10, 2005

Stamp No. 2106122 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, 2005. The **Municipality of Luquillo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality 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.

In our opinion, 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, 2005. 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, **05-03 through 05-11**.

**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)**

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 **05-03** through **05-11**.

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 **05-03, 05-04, 05-06, 05-07, 05-09** and **05-11** 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 3, 2006.



**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

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico

February 3, 2006

Stamp No. 2106123 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2005

Section I – Summary of Auditor’s Results

Financial Statements

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

Federal awards

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

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
14.228	Community Development Block Grant – State’s Program
14.871	Section 8 Housing Choice Voucher

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference	05-01
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.
Questioned Cost	None
Management Response and Corrective Action	The Municipality of Luquillo summarizes all transactions using the Uniform Mechanized Accounting System (SUCH) provided by OCAM. This system uses a cash basis accounting and registers the income when collected and record the expenses when paid.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference

05-01 (Continued)

In order to update the information in all the modules, OCAM programmed several visits to our Municipality to update the accounting information and assist the municipal's employees. Nevertheless, the Financial Director had implemented new internal controls in all departments to maintain updated accounting records. New procedures regarding the values received and disbursements have been established; all transactions are verify in a daily basis and summaries in the Model 4-A; also, the Model 4-A is compared every month with the accounting information and the bank reconciliation.

Implementation Date: During the fiscal year 2005-2006

Responsible Person: Mrs. Annette Caraballo
Finance Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference	05-02
Requirement	Expenditures for Goods and Services and Account Payables – Purchasing and Receiving
Statement of Condition	<p>We performed a cash disbursement test and examined seventy six (76) disbursement vouchers which belonged to current account, twenty one (21) which belonged to Community Development Block Grant (CDBG)– State Program, twenty (20) which belonged to Government Development Bank (GDB) loan, ten (10) which belonged to Joint Resolutions and nine (9) which belonged to Child Care Development Grant Program. The following will summarize the internal control exceptions noted:</p> <ul style="list-style-type: none">a. In fourteen (14) disbursement vouchers, the purchase order was issued after the receiving of goods of services. (Five (5) of these were related to current account, five (5) related to GDB loan, one (1) related to Joint Resolutions, two (2) related to Child Care Development Block Grant Program and one (1) related to Community Development Block Grant – State Program);b. One (1) disbursement voucher, related to GDB loan, was not available for our examination;c. Three (3) disbursement vouchers did not include the three (3) quotations required by law. (Two (2) of these were related to current account and the other, was related to Community Development Block Grant – State Program);d. Sixteen (16) disbursement vouchers did not include all supporting document marked as paid. (Four (4) of these were related to current account, ten (10) related to Community Development Block Grant – State Program and two (2) related to Child Care Development Block Grant Program);
Criteria	<p>The Revised Regulations on Basic Standards for the Municipalities of Puerto Rico establish in Chapter Four (4) that the Finance Director will be responsible to account and to prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions. Also, Chapter Eight (8) establishes the procedures related to the quotations for the purchase of goods or services.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II – Financial Statements Findings

Finding Reference **05-02 (Continued)**

Cause of Condition The Municipality internal control failed to assure that all transactions realized by the Municipality are supported by all the required documentation.

Effect of Condition The Municipality is not in compliance with Chapter Four (4) and Eight (8) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.

Recommendation We recommend to the Municipality's management to improve its internal control and procedures in order to assure that all disbursement vouchers are properly safeguarded, and to assure that disbursement vouchers includes all the required supporting documents before the issuance of any payment.

Questioned Cost None

Management Response and Corrective Action Regarding point (a), the Internal Auditor will give written instructions to the Purchasing Director and to all the staff in order to avoid purchases without the purchase order procedures; regarding point (b), the Finance Director will establish internal controls to maintain all the disbursement vouchers in a secure place; regarding point (c), as part of the municipal audits, periodic examinations will be made to verify that the Purchasing Department follows the procurement procedure required by law and; regarding point (d), after the disbursements, all of its supporting documents will be marked as paid by the Official Payer and his assistant, to avoid duplicate payments (we already take action regarding the sixteen (16) disbursements that wasn't stamped).

Also, in the case of the Federal Department, the three quotations were received in the office, but these subsequent were lost. As part of its correction action plan, they gave instructions to the program's accountant to not work any payment if it does not have complete documents.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II - Financial Statements Findings

Finding Reference

05-02 (Continued)

Implementation Date: March, 2006

Responsible Persons: Mrs. Annette Caraballo
Finance Director

Nelson Márquez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-03
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	We realized Cash Management Test and after our procedures, we found that the Municipality maintained during the current fiscal year, average cash balance in books of approximately \$85,749. At June 30, 2005, the cash balance in book was \$75,663. Of these funds, \$2,967 was from operating reserve, \$31,500 was from Family Self Sufficiency's program (related to the balance not yet spent), and the remaining \$41,196 was not identified by us with respects to its origin.
Criteria	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.
Cause of Condition	The Municipality did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.
Effect of Condition	The PHA did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).
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	We will take the following measures to correct the finding: (a) We will notify to the responsible person to identify the remaining amount of \$41,196 and; (b) we will establish internal controls and procedures to avoid similar situations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference

05-03 (Continued)

Implementation Date: March, 2006

Responsible Persons: Nelson Márquez
Federal Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-04**

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 We performed an eligibility test of fifteen (15) participant files and found the following exceptions:

- a. In one (1) case, the PHA paid an incorrect Housing Assistance Payment to the owner. As result, during the fiscal year 2004-2005, the program paid a HAP to the owner of \$3,489 instead of \$3,540.
- b. In four (4) cases, the PHA used an incorrect utility allowance for the HAP calculation. Also, in one (1) of these cases, an incorrect Fair Market Rent was used. The following summarize the differences between the monthly HAP calculated by the PHA and the monthly HAP calculated by us:

<u>Case Number</u>	<u>Monthly HAP calculate by PHA</u>	<u>Monthly HAP calculated by Auditor</u>
1	\$ 600	\$ 631
2	441	429
3	594	596
4	315	292

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. Also, 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).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section II - Financial Statements Findings

Finding Reference **05-04 (Continued)**

Recommendation We recommend the PHA to strengthen its monitoring procedures to assure that 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, and adjust the same retroactively to the date of the last reexamination, if need.

Questioned Costs None.

**Management Response
and Corrective Action** During the fiscal year 2005-2006, we gave instructions to the program staff to correct the situations commented in the finding. This condition was corrected in the month of March 2006.

Implementation Date: March 2006

Responsible Person: Nelson Márquez
Federal Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **05-05**

Program **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**

Requirement **Reporting - Financial Reporting**

Statement of Condition During our reporting test, we noted that the expenditures recorded in the Section 8 Housing Choice Vouchers program accounting records disagree with the Housing Assistant Payments and administrative expenditures reported in the Financial Quarterly Reports as follows:

Report period ended:	HAP and administrative expenditures per Financial Quarterly Reports	HAP and administrative expenditures per Accounting Records
9/30/2004	\$ 104,705	\$ 97,180
12/31/2004	114,097	103,684
3/31/2005	109,044	113,322
6/30/2005	105,870	112,487
Total	<u>\$ 433,716</u>	<u>\$ 426,673</u>

Criteria Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Also, Code of Federal Regulations 24, section 982.158 (a) states that the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference

05-05 (continued)

Cause of Condition

The PHA accounting controls and procedures failed to assure that the Financial Quarterly Reports were prepared according to Federal and State Regulations.

Effect of Condition

The Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) and section 982.158 (a).

Recommendation

We recommend the PHA should implement controls and procedures in order to assure accurate accounting records are maintained and current and complete disclosure of financial results are presented in the Financial Quarterly Reports.

Questioned Costs

None.

**Management Response
and Corrective Action**

As part of our correction action plan, we'll begin to make the Financial Quarterly Reports according to the program's accounting records.

Implementation Date: March, 2006

Responsible Person: Nelson Márquez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-06
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, 2005. 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 did not follow the procedures established to review utility rate date each year.
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	<p>The condition was corrected in the month of March 2006. In the month of April 2006, we will reflect the adjustment in the monthly HAP.</p> <p>Implementation Date: April, 2006</p> <p>Responsible Person: Nelson Márquez Federal Program Director</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Finding and Questioned Cost

Finding Reference	05-07
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	Allowable Activities
Statement of Condition	<p>We performed a housekeeper activities test of six (6) participant’s files and found the following exceptions:</p> <ul style="list-style-type: none">a) In three (3) participant’s files, there was no evidence of the copy of the social security;b) In one (1) participant’s file, there was no evidence of the certificate of birth;c) In one (1) participant’s file, there was no evidence of the approval form (OCAM-AH-004A);d) In six (6) participant’s files, there was no evidence of the participation contract between the Municipality and the participant, establishing the service plan to be offered (OCAM-AH-005).
Criteria	<p>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 Municipality has an operational guide that includes all procedures and program’s requirements for housekeeper activities.</p>
Cause of Condition	<p>The Municipality’s controls and procedures failed to assure that the participant’s files include all the required documents to comply with the program requirements.</p>
Effect of Condition	<p>The Municipality is not in noncompliance with Code of Federal Regulations 24, Section 570.484 and with the operational guide.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 05-07 (continued)

Recommendation We recommended management to follow the procedures established in the operational guide title “Guía Operacional para la Prestación del Servicio de Auxiliares del Hogar”, including the use of the forms included on it.

Questioned Costs None

Management Response and Corrective Action We will take the following measures to correct the finding: (a) We will notify the responsible person to proceed according the established rules; (b) establish internal controls and procedures to detect missing documents and; (c) establish a quality control program.

Implementation Date: April 2006

Responsible Person: Nelson Márquez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-08
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	Allowable Costs and Cost Principles
Statement of Condition	Section II – Financial Statement Findings – Finding Reference 05-02

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-09
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	Cash Management
Statement of Condition	During our cash management test, we noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, the program cash account maintained a monthly average cash balance of \$82,364 in books.
Criteria	Code of Federal Regulations 24, Subpart I, Sec.570.489 (c) requires a cash management system in order to minimize the time elapsed between the transfer of funds from the pass-through grantor and disbursements made by the grantee.
Cause of Condition	The Municipality’s disbursements procedures failed to assure that funds requested and received from the Pass-through Grantor be disbursed in compliance with the Code of Federal Regulations Requirements.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sec.570.489 (c).
Recommendation	We recommend management to strengthen it’s disbursement procedures to minimize the time elapsed between the transfer of funds from the Pass-through Grantor and the disbursements made by the Municipality.
Questioned Costs	None
Management Response and Corrective Action	In this case, the balance available in the accounts responds to a payment that could not be made since the contract for services had expired. The condition was corrected in the month of March 2006. The balance available is \$4,423.77. Implementation Date: March, 2006 Responsible Person: Nelson Márquez Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	05-10
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 two (2) contracts for the Community Development Block Grants – State’s Program, formalized during the fiscal year ended June 30, 2005. 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. Two (2) contracts did not include a provision for granting access to Gao or other Federally Agency, to books, documents, etc;c. Two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act;d. Two (2) contracts did not include provision for retention of all required records for three years;e. Two (2) contracts did not include provision for compliance with suspension and debarment.
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).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **05-10 (continued)**

Recommendation We recommend that the Municipality should strengthen it's procedures in order to assure that the contracts contain all provisions requested by federal agencies.

Questioned Costs None

Management Response and Corrective Action Our Office is not responsible for the contracts preparation, but in several occasions we have notified the responsible department regarding the obligatory clauses required by federal statutes, executive order and existing regulation. We will take the following measures to correct the finding: (a) Require our accountant not to process any purchase order without a complete contract; (b) notify the responsible Office about the importance of including all clauses in all contracts and; (c) Establish a quality control procedures.

Implementation Date: March, 2006

Responsible Person: Nelson Márquez
Federal Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 05-11

Program Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (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 June 30, 2005. The following summarize the differences between the amounts presented in the Financial Quarterly Report and the amounts presented in the program’s General Ledger:

Program Year	Amount per Quarterly Report	Amount per General Ledger	Difference
94-FD-41	\$ 118,787	\$ 127,325	\$ (8,538)
98-FD-41	128,347	126,323	2,024
99-FD-41	235,532	234,517	1,015
00-FD-41	1,908,944	2,128,489	(219,545)
02-AB-41	30,978	25,115	5,863
02-FC-41	37,833	33,796	4,037
03-AB-41	45,000	43,245	1,755
03-FC-41	194,249	245,430	(51,181)
04-FC-41	483	489	(6)

- b. The Financial Quarterly Report for the period ended December 31, 2004 was submitted to the Office of Commissioner of Municipal Affairs twenty three (23) days after the deadline.
- c. For the periods ended September 30, 2004 and March 31, 2005, we did not obtain evidence to assure us that the Financial Quarterly Reports were timely submitted to the Office of Commissioner of Municipal Affairs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	05-11 (continued)
	d. Program year report 2000 and 2003, included as part of the Financial Quarterly Report ended on June 30, 2005, has mathematical differences in the total column.
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's record retention control and procedures failed to assure that the submitted evidence of the Financial Quarterly Report were maintained safeguarded and available for examination by us during the application of planned audit procedures. Also, accounting control and procedures failed to assure that those reports are prepared according Program's accounting records.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1).
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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Section III - Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **05-11 (continued)**

**Management Response
and Corrective Action**

During the fiscal year 2005-2006, we gave instructions to the program staff to record any necessary adjustment to correct the situations commented in the finding. This condition was corrected in the month of March 2006.

Implementation Date: March, 2006

Responsible Person: Nelson Márquez
Federal Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-02	14.871	<p><u>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 with respects to its origin.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-03.</p>
04-03	14.871	<p><u>In ten (10) 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". 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.</u></p> <p>Full corrective action was taken.</p>
04-04	14.871	<p><u>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.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-06.</p>
04-05	14.228	<p><u>Three (3) housekeeping assistance project 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; eight (8) participant's files did not have evidence of the approval form (OCAM-AH-004A); 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) and; 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.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-07.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
04-06	14.228	<p><u>Davis-Bacon Act test - For the construction projects 00-FD-41-007, the Municipality did not monitored the weekly payrolls submitted by the contractor to assure the compliance with prevailing wage rates.</u></p> <p>Full corrective action was taken.</p>
04-07	14.228	<p><u>Procurement test - Two (2) contracts did not include a provision for compliance with the Clean Air Act and Water Act; three (3) contracts did not include a provision for compliance with Energy Policy and Conservation Act and; one (1) contract did not include provisions for retention of all required records for three years.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-10.</p>
04-08	14.228	<p><u>Financial Quarterly Reports - several differences were found between the amounts presented in the Financial Quarterly Reports and the amounts presented in the program's General Ledger; 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 and; 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.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-11.</p>
04-09	93.575	<p><u>On fifteen (15) disbursement vouchers the Municipality did not cancelled or marked as paid the documents along the disbursements voucher; on one (1) disbursement vouchers there was no evidence of the original invoice; 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; on four (4) disbursement vouchers the Purchase Order was issued after the receiving of goods or services; nine (9) cancelled checks were not available for our examination.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-02.</p>
04-10	93.575	<p><u>For seven (7) participants, the Municipality miscomputed the monthly gross income or the monthly deductions as part of the eligibility</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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>determination. As result, in six (6) cases the parent contribution was incorrect.</u></p> <p>Full corrective action was taken.</p>
04-11	93.575	<p><u>No evidence was maintained of the submission by the Municipality of the Equipment Inventory and the Trial Balance as of September 30, 2003 and September 30, 2004, respectively. Also, no evidence was found of the submission date of the Annual Closing Report (CC-006) for the program fiscal years ended September 30, 2003 and September 30, 2004.</u></p> <p>No corrective action has been taken. The Municipality's Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation.</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 05-04.</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 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 the auditors could not determine its origin. Also, during seven months of the</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2005

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>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 05-03.</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 05-06.</p>
03-12	14.228	<p><u>During the examination of reporting, the auditors verified the Financial Quarterly Report ended on June 30, 2003. They found differences between the amounts presented in the Financial Quarterly Report and the amounts presented in the program's General Ledger.</u></p> <p>No corrective action has been taken. The Auditors reissued the finding for the current year. Finding Reference 05-11.</p>
02-13	14.871	<p><u>During the verification of twenty three (23) participant files, the auditors noted several exceptions related to the Housing Assistance Payment calculations.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
02-19	14.871	<p><u>The Municipality did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2002. There is no evidence of the last time that the Utility Allowance Schedule was actualized.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>