

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

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

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO**

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULES**

With Independent Auditors' Report Thereon
June 30, 2003

MUNICIPALITY OF MARICAO, PUERTO RICO

FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULE
YEAR ENDED JUNE 30, 2003

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MUNICIPALITY OF MARICAO, PUERTO RICO

**FINANCIAL STATEMENTS AND SUPPLEMENTAL SCHEDULE
ENDED JUNE 30, 2003**

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INDEPENDENT AUDITORS' REPORT

**The Honorable Mayor, Members of the
Municipal Legislature and People of
the Municipality of Maricao
Maricao, PR**

I have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Maricao of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2003, which collectively comprise the Municipality's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I 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 statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit and the report of other auditors provide a reasonable basis for my opinion.

In my 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 Maricao of the Commonwealth of Puerto Rico as of June 30, 2003, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, I have also issued my report dated December 30, 2003 on my consideration of the Government's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of my audit.

My audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a 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 general purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

Mailing Address Box 757, Dorado, PR 00646

The municipality discontinued the land fill operation in 1993; state and federal law regulations required perform certain closure prodecures and established monitoring and maintenance function at the landfill for 30 years after closure.

As the date of this report there is no sufficient information to determine the amount that will affect the municipality financial position.

As described in Note 1, on July 1, 2002 the Municipality has implemented a new financial reporting model, required for state and local governments established by the Governmental Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis- for States and Local Governments. As more fully decribed in Note 1, as part of the adoption of the new financial reporting model, on July 01, 2002 the Municipality also adopted the provisions of other pronouncements issued by GASB, the Accounting Priciples Board ("APB") and the Financial Accounting Standards Board ("FASB)..

As described in Note 10 the municipality contracted outside consultant firm with expertise in assets valuation to update the municipality property ledger.

The effects of implementing the aforementioned pronouncements have been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the effects of such transactions have been retroactively reported as restatements of fund balances in the accompanying fund financial statements at July 1, 2002.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule-are not a required parts of the basic financial statements referred to above, but are supplementary information required by the Governmental Accounting Standards Board (GASB). I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation and of the required supplementary information. However, I did not audit the information and express no opinion there on


Juan Rivera, CPA
License 2214

December 30, 2003
Toa Baja, Puerto Rico

Stamp No. 1931655 of the Puerto Rico Society of Certified Public Accountants was affixed to the record copy of this report.

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

Management of the Municipality of Maricao of the Commonwealth of Puerto Rico (the "Municipality") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2003, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, issued by the Governmental Accounting Standards Board (commonly known as "GASB 34"). According to this statement, significant required changes in content and structure have been made in the accompanying Municipality's basic financial statements as of and for the fiscal year ended June 30, 2003, which make the accompanying basic financial statements not easily comparable to the Municipality's general purpose financial statements issued in prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of GASB 34, and it has been designed accordingly with the following goals:

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

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

FINANCIAL HIGHLIGHTS

- The Municipality's has reported assets and net assets amounting to \$7,296,371 and \$(2,846,538), respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to \$4,643,222 for 64 percent of total Municipality's assets.
- The Municipality has reported total liabilities amounting to \$10,142,910 in the accompanying statement of net assets, of which the most significant liabilities are: (1) loan payable to governmental entities \$(4,021,646), (2) intergovernmental \$(2,119,117), (3) bond and notes \$(1,573,932), (4) accrued compensated absences \$(994,970) and (5) deferred revenues \$(701,761). These liabilities account for 94 percent of the Municipality's total liabilities at June 30, 2003.
- The Municipality has reported total revenues amounting to \$5,360,485 in the accompanying statement of activities, of which: (1) unrestricted intergovernmental grants and reimbursements \$(532,816), (2) restricted capital and operating grants \$(1,143,994), (3) property taxes \$(3,416,875) and (4) municipal licenses \$(126,502) were the most significant revenues amounting to \$5,220,187 (97 percent of total revenues).

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

- The Municipality has reported a net change in net assets (excess of revenues over expenses) amounting to \$20,425 in the accompanying statement of activities.
- The Municipality's governmental funds reported combined ending fund balances of \$(1,121,189) of which \$889,670 (79 percent) represent the fund balances of the general fund, the debt service fund, FEMA georges and the joint resolutions fund combined (jointly known as the Municipality's major funds).
- The Municipality has reported unreserved fund balance for the general fund amounting to \$(1,469,140).
- The Municipality has reported a deficiency of expenditures and other financing uses over revenues and other financing sources amounting to \$(109,623) in the governmental funds.

USING THIS ANNUAL REPORT

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

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedules) and other supplementary information (combining financial statements) in addition to the basic financial statements themselves. These components are described below:

Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2003 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

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

Statement of Net Assets

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

Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2003. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

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

Fund Financial Statements

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

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental

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

activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year (June 30, 2003). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

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

For financial reporting purposes the Municipality has four major funds: (1) the general fund, (2) the debt service fund, (3) FEMA (Georges) and (4) the joint resolutions fund.

Notes to the Basic Financial Statements

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

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

INFRASTRUCTURE ASSETS

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

As of July 1, 2002, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

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

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets serve as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of liabilities over assets) amounted to \$(2,846,538) at June 30, 2003.

The largest portion of the Municipality's net assets are invested in capital assets net of their related debt \$(3,098,222). The Municipality's net assets are also composed of net assets amounting to \$1,905,239 that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net assets are reported net of unrestricted assets of \$(7,849,999).

The unrestricted deficit is the consequence of previous budgets, which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

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

Condensed Statement of Net Assets:

| | |
|---|----------------|
| Current and other assets | \$ 747,910 |
| Noncurrent and other assets | 6,548,461 |
| Total assets | 7,296,371 |
| Long-term liabilities outstanding | 6,590,548 |
| Other liabilities | 3,552,362 |
| Total liabilities | 10,142,910 |
| Net assets/(liabilities): | |
| Invested in capital assets, net of related debt | 3,098,222 |
| Restricted | 1,905,239 |
| Unrestricted | (7,849,999) |
| Total net assets | \$ (2,846,538) |

Changes in Net Assets

The Municipality's net assets increased by \$20,245 during the year. Approximately 67 percent of the Municipality's total revenues came from taxes, while 32 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for economic development (38 percent), general government (25 percent), public housing and welfare (12 percent).

The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

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

Condensed Statement of Activities:

| | |
|------------------------------------|-----------------------|
| Revenues: | |
| Program revenues: | |
| Operating grants and contributions | \$ 971,958 |
| Capital grants and contributions | 172,037 |
| Charge for service and rents | 54,228 |
| General revenues: | |
| Property taxes | 3,416,875 |
| Municipal license taxes | 126,502 |
| Other | 618,885 |
| Total revenues | <u>5,360,485</u> |
| | |
| Expenses: | |
| General government | 1,308,988 |
| Public safety | 303,576 |
| Economic development | 2,045,526 |
| Culture, recreation and education | 221,420 |
| Sanitation | 65,891 |
| Health | 423,074 |
| Public housing and welfare | 653,181 |
| Interest | 318,404 |
| Total expenses | <u>5,340,060</u> |
| | |
| Net increase in net assets | 20,425 |
| | |
| Net assets - at beginning of year | <u>(2,866,963)</u> |
| Net assets - at end of year | <u>\$ (2,846,538)</u> |

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS

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

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

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

Condensed Balance Sheet - Governmental funds:

| | |
|------------------------------------|---------------------|
| Total Assets - Major Funds | \$ 3,191,091 |
| Total Assets - Nonmajor Funds | <u>533,687</u> |
| Total assets | <u>3,724,778</u> |
| Total Liabilities - Major Funds | 2,301,420 |
| Total Liabilities - Nonmajor Funds | <u>302,169</u> |
| Total liabilities | <u>2,603,589</u> |
| | |
| Fund Balances - Major Funds | 889,670 |
| Fund Balances - Nonmajor Funds | <u>231,519</u> |
| Total net assets | <u>\$ 1,121,189</u> |

Condensed Statement of Operations - Governmental funds:

| | |
|-------------------------------------|---------------------|
| Total Revenues - Major Funds | \$ 4,580,433 |
| Total Revenues - Nonmajor Funds | <u>619,083</u> |
| Total revenues | <u>5,199,516</u> |
| Total expenditures - Major Funds | 4,683,137 |
| Total expenditures - Nonmajor Funds | <u>626,002</u> |
| Total expenditures | <u>5,309,139</u> |
| | |
| Revenues Over Expenses - Major | (102,705) |
| Revenues Over Expenses - Nonmajor | <u>(6,918)</u> |
| Total net assets | <u>\$ (109,623)</u> |

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality 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.

The accompanying Budgetary Comparison Schedule shows a negative variance between budgeted revenues and actual revenue results of \$217,273, which was mainly caused by a negative variance of \$71,272 in interest and \$65,596 in rent property.

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

In addition, the accompanying Budgetary Comparison Schedule shows a total positive variance between budgeted expenditures and actual expenditure results of \$462,683.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$8,162,798, of which \$4,011,299 represents building, structures and building improvements assets at June 30, 2003. The related accumulated depreciation and amortization of capital assets amounted to \$3,519,576, of which \$1,185,631 is related to building, structures and building improvement assets at June 30, 2003. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, and similar items.

Actual costs incurred to purchase or construct capital assets were \$50,370 for the year ended June 30, 2003. Depreciation and amortization charges for the year totaled \$248,675.

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

Debt Administration

The laws and regulations of the Commonwealth of Puerto Rico have 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 laws and regulations also require 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 the Government Development Bank for Puerto Rico, 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 laws and regulations 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

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

to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT BUDGETS AND RATES

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal year. There were no significant changes between the budget for fiscal year 2002-2003 and the one for fiscal year 2003-2004.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mr. Modesto Ayala Quiñones at PO Box 837, Maricao, Puerto Rico, 00606-0837.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Statement of Net Assets
June 30, 2003

ASSETS

Current Assets:

Receivables, net of allowance for doubtful accounts (note 1h):

Taxes:

| | | |
|----------------------------------|------------|--|
| Property taxes (note 4) | \$ 150,701 | |
| Municipal license taxes (note 3) | 15,951 | |
| Total taxes receivable | 166,652 | |

| | | |
|-----------------------------|---------|---------|
| Intergovernmental (note 1h) | 581,258 | |
| Total receivables | | 747,910 |

Total current assets

747,910

Noncurrent Assets:

| | | |
|---|--|-----------|
| Temporarily restricted cash and cash equivalents (notes 1g and 3) | | 1,905,239 |
|---|--|-----------|

| | | |
|---|--|-----------|
| Capital assets, net of accumulated depreciation and amortization (notes 1j and 6) | | 4,643,222 |
|---|--|-----------|

| | | |
|-------------------------|--|-----------|
| Total noncurrent assets | | 6,548,461 |
|-------------------------|--|-----------|

| | | |
|--------------|--|--------------|
| Total assets | | \$ 7,296,371 |
|--------------|--|--------------|

LIABILITIES

Current liabilities:

| | | |
|----------------|--|------------|
| Bank overdraft | | \$ 150,434 |
|----------------|--|------------|

| | | |
|---|--|---------|
| Accounts payable and other accrued liabilities (notes 1h) | | 265,540 |
|---|--|---------|

| | | |
|---|--|--------|
| Accrued interests on bonds, notes and obligations under capital leases (note 8) | | 44,442 |
|---|--|--------|

| | | |
|-----------------------------|--|-----------|
| Intergovernmental (note 1h) | | 2,119,117 |
|-----------------------------|--|-----------|

| | | |
|---------------------------------------|--|---------|
| Deferred revenues (notes 1k, 4 and 5) | | 701,761 |
|---------------------------------------|--|---------|

| | | |
|--|--|---------|
| Bonds and notes payable (notes 1r and 8) | | 271,068 |
|--|--|---------|

| | | |
|---------------------------|--|-----------|
| Total current liabilities | | 3,552,362 |
|---------------------------|--|-----------|

Noncurrent liabilities:

| | | |
|--|--|---------|
| Accrued compensated absences, excluding current portion (notes 1l) | | 994,970 |
|--|--|---------|

| | | |
|--|--|-----------|
| Loan payables to governmental agencies | | 4,021,646 |
|--|--|-----------|

| | | |
|---|--|-----------|
| Bonds and notes payable, excluding current portion (notes 1m and 8) | | 1,573,932 |
|---|--|-----------|

| | | |
|------------------------------|--|-----------|
| Total noncurrent liabilities | | 6,590,548 |
|------------------------------|--|-----------|

| | | |
|-------------------|--|------------|
| Total liabilities | | 10,142,910 |
|-------------------|--|------------|

NET ASSETS

| | | |
|---|--------------|--|
| Invested in capital assets, net of related debt | \$ 3,098,222 | |
|---|--------------|--|

Restricted for (1j):

| | | |
|--------------|---------|--|
| Debt service | 344,723 | |
|--------------|---------|--|

| | | |
|------------------|-----------|--|
| Capital projects | 1,091,476 | |
|------------------|-----------|--|

| | | |
|---------------------------------------|---------|--|
| Advances and other specified purposes | 469,040 | |
|---------------------------------------|---------|--|

| | | |
|-----------------------------|-----------|--|
| Total restricted net assets | 1,905,239 | |
|-----------------------------|-----------|--|

| | | |
|------------------------------|-------------|--|
| Unrestricted net liabilities | (7,849,999) | |
|------------------------------|-------------|--|

| | | |
|-----------------------|--|----------------|
| Total net liabilities | | \$ (2,846,538) |
|-----------------------|--|----------------|

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Statement of Activities
Year Ended June 30, 2003

| Functions/Programs | Expenses | Charges for services and rents | Program Revenues | | Net Expenses and Changes in Net Assets |
|--|---------------------|--------------------------------|------------------------------------|----------------------------------|--|
| | | | Operating Grants and Contributions | Capital Grants and Contributions | |
| Governmental activities:(note 1c) | | | | | |
| General government | \$ 1,308,988 | \$ 54,228 | | | \$ (1,254,760) |
| Public safety | 303,576 | | \$ 57,090 | | (246,486) |
| Economic development | 2,045,526 | | 365,354 | \$ 172,037 | (1,508,135) |
| Culture, recreation and education | 221,420 | | | | (221,420) |
| Sanitation | 65,891 | | | | (65,891) |
| Health | 423,074 | | | | (423,074) |
| Public housing and welfare | 653,181 | | 549,514 | | (103,667) |
| Interest on bonds, notes, capital lease obligations and long-term debt | 318,404 | | | | (318,404) |
| Total governmental activities | \$ 5,340,060 | \$ 54,228 | \$ 971,958 | \$ 172,037 | \$ (4,141,837) |
| General revenues: | | | | | |
| Taxes | | | | | |
| Property taxes (note 5) | | | | | \$ 3,416,875 |
| Municipal license taxes (note 4) | | | | | 126,502 |
| Other taxes | | | | | 66,850 |
| Total taxes | | | | | 3,610,227 |
| Unrestricted interests, fines and penalties | | | | | 19,219 |
| Other revenues | | | | | 532,816 |
| Total general revenues | | | | | 4,162,262 |
| Net change in net assets | | | | | 20,425 |
| Net assets-beginning of fiscal year, as restated (note 13) | | | | | (2,866,963) |
| Net liabilities-end of fiscal year | | | | | \$ (2,846,538) |

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
 Balance Sheet
 Governmental Funds
 June 30, 2003

| | Major Funds | | | | OTHER NONMAJOR FUNDS | TOTAL GOVERNMENTAL FUNDS |
|--|--------------------|----------------------|-------------------|----------------------|----------------------------|--------------------------------|
| | GENERAL FUND | DEBT SERVICE FUND | FEMA GEORGES | JOINT RESOLUTIONS | | |
| ASSETS | | | | | | |
| Cash | | | | | | |
| Cash with fiscal agent | | | | | | |
| Temporarily restricted cash and cash equivalents | | \$ 344,723 | \$ 723,815 | \$ 367,661 | \$ 469,040 | \$ 1,905,239 |
| Receivables net of allowance for doubtful accounts | | | | | | |
| Property Taxes | \$ 150,701 | | | | | 150,701 |
| Municipal License | 15,951 | | | | | 15,951 |
| Accrued Interest | | | | | | - |
| Due from other funds | 107,666 | | | 1,015,422 | 7,748 | 1,130,836 |
| Due from governmental entities | 464,994 | 157 | | | 9,809 | 474,960 |
| Federal financial assistance | | | | | 47,090 | 47,090 |
| Total Assets: | \$ 739,312 | \$ 344,880 | \$ 723,815 | \$ 1,383,084 | \$ 533,687 | \$ 3,724,778 |
| LIABILITIES AND FUND BALANCES | | | | | | |
| Bank overdraft | \$ 150,434 | | | | | \$ 150,434 |
| Accounts payable and accrued expenses | 119,085 | | | | | 119,085 |
| Matured bonds due and payable | | \$ 249,442 | | | | 249,442 |
| Due to other funds | 1,016,290 | 468 | | \$ 6,881 | \$ 107,199 | 1,130,837 |
| Due to other governmental entities | | | | | | |
| Deferred volume of business tax | 151,761 | | | | | 151,761 |
| Deferred federal financial assistance revenue | | | | | 194,971 | 194,971 |
| Deferred intergovernmental revenue | 607,060 | | | | | 607,060 |
| Total Liabilities: | 2,044,629 | 249,910 | - | 6,881 | 302,169 | 2,603,589 |
| Fund balances: | | | | | | |
| Reserved for encumbrances | 163,822 | | | | | 163,822 |
| Reserved for debt service | | | | | | |
| Unreserved | | | | | | |
| Designated for future year expenditures | | | | | | |
| Unreserved fund balance (deficiency) | (1,469,140) | 94,970 | 723,815 | 1,376,203 | 231,519 | 957,367 |
| Total Fund Balances: | (1,305,318) | 94,970 | 723,815 | 1,376,203 | 231,519 | 1,121,189 |
| TOTAL LIABILITIES AND FUND BALANCES | \$ 739,311 | \$ 344,880 | \$ 723,815 | \$ 1,383,084 | \$ 533,687 | \$ 3,724,778 |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Statement of Revenues, Expenditures and
Changes in Fund Balance - Governmental Funds
Year-Ended June 30, 2003

| | Major Funds | | | | OTHER NONMAJOR FUNDS | TOTAL GOVERNMENT/ FUNDS |
|---|---------------------|----------------------|-------------------|----------------------|----------------------------|-------------------------------|
| | GENERAL FUND | DEBT SERVICE FUND | FEMA GEORGES | JOINT RESOLUTIONS | | |
| REVENUES | | | | | | |
| Property taxes | \$ 3,277,196 | | | | | \$ 3,277,196 |
| Volume of business tax | 193,352 | | | | | 193,352 |
| License and permits | | | | | | |
| Intergovernmental revenues | 402,028 | \$ 89,990 | | \$ 172,037 | \$ 10,000 | 674,05 |
| Federal financial assistance | | | \$ 365,354 | | 607,743 | 973,09 |
| Rent of property | 54,228 | | | | | 54,22 |
| Interest | 18,404 | | | 623 | 192 | 19,21 |
| Miscellaneous | 7,221 | | | | 1,148 | 8,36 |
| Total Revenues: | \$ 3,952,429 | \$ 89,990 | \$ 365,354 | \$ 172,660 | \$ 619,083 | \$ 5,199,51 |
| EXPENDITURES | | | | | | |
| General government | \$ 1,198,656 | | | | \$ 1,273 | \$ 1,199,92 |
| Public safety | 227,388 | | | | 53,571 | 280,95 |
| Economic development | 1,544,507 | | \$ 158,243 | \$ 195,082 | 13,396 | 1,911,22 |
| Culture, recreation and education | 146,785 | | | | 2,679 | 149,46 |
| Sanitation | 63,790 | | | | | 63,79 |
| Health | 409,015 | | | | | 409,01 |
| Public housing and welfare | 83,587 | | | | 555,083 | 638,67 |
| Debt Service: | | | | | | |
| Payment of principal | 82,311 | \$ 205,000 | | | | 287,31 |
| Payment of interest | 227,961 | 90,443 | | | | 318,40 |
| Capital outlays | 50,370 | | | | | 50,37 |
| Total Expenditure: | 4,034,369 | 295,443 | 158,243 | 195,082 | 626,002 | 5,309,13 |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES | (81,940) | (205,453) | 207,111 | (22,422) | (6,918) | (109,62) |
| OTHER FINANCING SOURCES (USES) | | | | | | |
| Proceeds from issuance of long term debt | | | | | | |
| Operating transfer from other fund | | 182,250 | | | | 182,25 |
| Operating transfer to other fund | (182,250) | | | | | (182,25) |
| Total Other Financing Sources (uses) | (182,250) | 182,250 | | | | |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES AND OTHER SOURCES (USES) | (264,190) | (23,203) | 207,111 | (22,422) | (6,918) | (109,62) |
| PRIOR PERIOD ADJUSTMENTS | 893,487 | (100,260) | 4,888 | 96,875 | (38,773) | 856,21 |
| FUND BALANCE AT BEGINNING OF YEAR | (1,934,615) | 218,434 | 511,816 | 1,301,750 | 277,210 | 374,59 |
| FUND BALANCE AT END OF YEAR | \$ (1,305,317) | \$ 94,971 | \$ 723,815 | \$ 1,376,203 | \$ 231,518 | \$ 1,121,18 |

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

Handwritten note:
 - K(1,305,317)
 at transfer fund balance correct
 13/02/04
 [Signature]

MUNICIPALITY OF MARICAO
 Reconciliation of Statement of Revenues,
 Expenditures and Changes in Fund Balances
 Governmental Funds to the Statement of Activities
 Year Ended June 30, 2003

Amounts reported for governmental activities in the accompanying statement are different because:

| | |
|--|------------------|
| Net change in fund balances as reported in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds | \$ (109,623) |
| Governmental funds report capital outlays as expenditures. However, in the accompanying statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period. | (198,305) |
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the fund financial statements. | 160,968 |
| Repayment of bond and notes principal is recorded as expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. | 287,311 |
| Generally expenditures recognized in this fund's financial statements are limited to only those that use current financial resources but expenses are recognized in the statement of activities when they are incurred. | (81,297) |
| Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. | <u>(38,629)</u> |
| Net change in net assets as reported in the accompanying statement of activities | <u>\$ 20,425</u> |

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Maricao (the Municipality) is a local municipal government located in Puerto Rico and constituted with full legislative, fiscal and all other governmental powers and responsibilities expressly assigned to the government of the Commonwealth of Puerto Rico (the Commonwealth).

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth provides for the separation of powers of the executive, legislative and judicial branches. A Mayor elected every four years by the citizens exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes responsibility for providing services related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2003 in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

a) New Financial Reporting Model

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments* (GASB No. 34). This statement establishes new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below as of July 1, 2002. These statements require the reporting of new financial information and restructure much of the information that governments have reported in the past. Comparability with financial statements issued in prior years has been affected significantly.

According to the new financial reporting model established by GASB No. 34, the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) Government-Wide Financial Statements (GWFS), (2) Fund Financial Statements, (3) Notes to Basic Financial Statements, and (4) Required Supplementary Information (RSI).

The RSI is a set of reports and information reported along with, but separate from, the Municipality's basic financial statements. In the accompanying basic financial statements, the required RSI is composed of the following elements: (1) Management Discussion and Analysis (MD&A) and, (2) the Schedule of Funding Progress - Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2003, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

The accompanying Schedule of Funding Progress - Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities provides an unaudited three-year trend information (using latest data available) of the funding status of ERS, which is a multi-employer cost-sharing retirement system in which the Municipality is a participating employer.

As previously mentioned, other statements and interpretations were required to be adopted in conjunction with GASB No. 34. Therefore, the Municipality has also adopted the following pronouncements at July 1, 2002: (1) GASB Statement No. 33 - *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 - *Certain Financial Statement Note Disclosures*, and, (4) GASB Interpretation No. 6 - *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB No. 34 also requires that the accounting for all governmental activities reported in the GWFS be based on applicable pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB), issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict GASB pronouncements. Accordingly, simultaneously with the adoption of GASB No. 34, the Municipality also adopted the following pronouncements: (1) APB Opinion No. 20 - *Accounting Changes*, (2) APB Opinion No. 21 - *Interest on Receivables and Payables*, (3) FASB Statement No. 5 - *Accounting for Contingencies*, and (4) FASB Statement No. 16 - *Prior Period Adjustments*. The Municipality has elected to not apply all Statements and Interpretations issued by FASB after November 30, 1989, in accordance with GASB No. 20.

The effects of implementing the aforementioned pronouncements have been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the cumulative effects of the adoption of such pronouncements have been reported as restatements of fund balances/deficits at July 1, 2002 in the accompanying governmental fund financial statements (see note 9).

b) *Financial Reporting Entity*

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor, and (2) whose funds are under the legal custody and control of the Municipality's Director of Finance, as

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

prescribed by Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico*.

The Municipality's management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, - *The Financial Reporting Entity* (GASB No. 14), has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Municipality.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of June 30, 2003 nor for the year then ended.

The GASB recently issued its Statement No. 39, *Determining Whether Certain Organizations are Component Units* (GASB No. 39). This statement is effective for the Municipality's next fiscal year and amended the provisions of GASB No. 14 to provide additional guidance to determine whether certain organizations for which the Municipality is not financially accountable should be reported as component units based on the nature and significance of their relationship with the Municipality. Generally, GASB No. 39 will require reporting, as a discretely presented component unit, an organization that raises and holds economic resources for the direct benefit of a governmental entity. Such organizations are legally separate, tax-exempt entities that meet all of the three specific criteria that address benefit, entitlement or access, and significance. At June 30, 2003, the Municipality has not adopted the provisions of GASB No. 39, however, the Municipality's management has concluded that the future adoption of GASB No. 39 will not have an impact on the Municipality's basic financial statements since no change in the Municipality's financial reporting entity is expected.

c) *Government-Wide Financial Statements*

The accompanying government-wide financial statements (GWFS) are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements do not report fund information but rather report information of all of the Municipality's non-fiduciary governmental activities. These statements are aimed at presenting a broad overview of the Municipality's finances through reporting its financial position and results of operations as a whole, using methods that are similar to those used by most private businesses.

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity) or "net liabilities" (deficit). This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure; and discloses legal and contractual restrictions on resources.

Net assets (liabilities) are classified in the accompanying statement of net assets within the following three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by the outstanding balances of bonds, notes and any other debt that are attributed to the acquisition, construction, or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted Net Assets** – These consist of net assets restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation is defined as legislation that authorizes the Municipality to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net assets is intended to identify resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources which are subject to change at the discretion of the Municipal Legislature.

- **Unrestricted Net Assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2003, using the net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs, or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) economic development, (3) public safety, (4) health (5) sanitation, (6) culture, recreation and education, and (7) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General Government:

- Municipal Legislature
- Mayor's Office
- Department of Finance
- Department of Human Resources
- Department of Municipal Secretary
- Department of Internal Audit
- Department of Federal Programs
- Department of Public Relations

Economic Development:

- Department of Public Works

Public Safety:

- Department of Civil Defense
- Department of Municipal Police

Health and Sanitation

- Department of Health

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

Culture, Recreation and Education:

Department of Recreation and Sports

Public Housing and Welfare:

Center for the Elderly

The statement of activities demonstrates the degree to which direct expenses of a given function/program or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizenry. In the statement of activities, program revenues reduce the cost (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.

- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct, or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes and construction excise taxes are reported as general revenues. All other nontax revenues (including unrestricted investment earnings, grants and contributions and special items, among others) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

program revenues. All general revenues are reported net of estimated uncollectible amounts which are recorded as reduction of revenues rather than as expenses.

The *general government* function/program reported in the accompanying statement of activities, includes expenses that are, in essence, indirect or overhead expenses of the Municipality's other functions/programs. Even though some of these costs have been charged to other funds in the governmental fund financial statements as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect expenses as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) expenses to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues, and other nonexchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the governmental fund financial statements.

The accompanying GWFS do not report fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no significant operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges. Accordingly, the accompanying GWFS do not report fiduciary nor business-type activities.

d) Governmental Fund Financial Statements

The accompanying governmental fund financial statements (GFFS) are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses, and balances of current financial resources. These financial statements often have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability, and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year).

Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity or deficit, revenue, and expenditures. The accompanying GFFS segregate governmental funds according to their

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- **General Fund** – The general fund is the Municipality’s chief operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund type. It is presumed that the Municipality’s governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements, or (3) the demands of sound financial administration requiring the use of a fund other than the general fund.
- **Special Revenue Funds** – The special revenue funds are major and nonmajor funds used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes.

However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality’s general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

- **Debt Service Fund**– The debt service fund is a major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund, and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as capital leases, compensated absences, claims and judgments, notes payable to CRIM and federal government, federal cost disallowances, and solid waste landfill closure and post-closure costs, among others) are accounted for in the general fund. Long-term debt’s principal and accrued interests due on July 1 of the following fiscal year are accounted for as fund liabilities in the debt service fund at June 30, if resources are available at June 30 for its payment.
- **Capital Projects Funds** – Capital projects funds are nonmajor funds, as defined below, used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Significant capital outlays financed from general obligation bond proceeds are accounted for also in the capital projects funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
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The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

Prior to GASB No. 34, the Municipality was required to report governmental fund financial statements that presented a single aggregated column for each fund type. Each column presented the combined total of all funds of a particular type. Fund types are still reported in certain cases, but they are no longer the focus of the accompanying governmental fund financial statements. Under GASB No. 34, the focus of the governmental fund financial statements is on major funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds among major and nonmajor categories within the governmental fund financial statements. Major individual governmental funds are reported as individually as separate columns in the governmental fund financial statements, while data from all nonmajor governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes means all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the general fund, (2) the debt service fund (3) FEMA (George) (4) joint resolutions.

The state legislative joint resolutions special revenue fund is a major fund used to account for financial resources derived from operating grants awarded each year by the Commonwealth's Senate and House of Representatives (the Commonwealth's Legislature). The purpose of the amounts awarded by the Commonwealth's Legislature vary from year to year, but are generally restricted to (1) partially subsidize certain qualifying administrative and operational activities of the Municipality, (2) provide specific multipurpose services to citizens, and (3) finance the acquisition or construction of capital assets approved by the Commonwealth's Legislature.

As previously discussed, the Municipality has no assets held in a trustee or agency capacity for others, nor has significant operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges. As a result, the Municipality does not report fiduciary nor proprietary funds in the accompanying basic financial statements.

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e) *Measurement Focus and Basis of Accounting*

Government-Wide Financial Statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including investment earnings) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2002. GASB No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues; (b) government mandated nonexchange transactions; and (c) voluntary nonexchange transactions.

In the case of derived tax revenue transactions (such as municipal license taxes), which result from assessments the Municipality places on exchange transactions, receivables and revenues or deferred revenues as needed are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place or in the first period that the use of the resources is permitted).

In the case of imposed nonexchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes are generally recorded as revenues (net of amounts considered not collectible) in the period when resources are required to be used or the first period that the use of the resources is permitted.

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Government-mandated nonexchange transactions (such as federal and state grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, resources must be expended by the Municipality on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary nonexchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these type of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated nonexchange transactions discussed above.

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues.

Events that are neither exchange nor nonexchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations with brief explanations to better identify the relationship between the GWFS and the GFFS.

Governmental Fund Financial Statements - The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2003, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criteria or collected in advance are recorded as deferred revenues at June 30, 2003. The principal revenue sources considered susceptible to accrual include property taxes, intergovernmental grants and contributions, and investment earnings. These principal revenue sources meet the measurability and availability criteria in the accompanying GFFS.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services, and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

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All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the previously discussed criteria set forth by GASB No. 33, but subject to and limited by the availability criteria discussed above. Accordingly, municipal license tax receivables and revenues are generally recorded when the underlying exchange has occurred. Property tax receivables are also generally recorded in the period when an enforceable legal claim has arisen while property tax revenues (net of amounts considered not collectible) are also generally recorded in the period when resources are required to be used or the first period that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally as qualifying reimbursable expenditures are incurred).

Investment earnings are recorded when earned only if collected within 90 days after year-end since they would be considered both measurable and available.

As previously discussed, on July 1, 2002, the Municipality adopted the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), which modifies the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting and clarifies a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

Pursuant to the provisions of GASBI No. 6, expenditures and related liabilities are generally recorded in the accompanying governmental fund financial statements in the accounting period in which the liability is incurred, as under the accrual basis of accounting, but only to the extent that they are normally expected to be liquidated with expendable financial resources.

Modifications to the accrual basis of accounting include:

- Employees' accumulated vacation, sick leave and compensatory time (compensated absences) is recorded as expenditure when utilized. The amount of the unpaid compensated absences has been reported only in the GWFS.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due in July 1 of the following fiscal year, which are recorded when resources are available in the debt service funds (generally June 30).
- Obligations under capital leases, solid waste landfill closure and post closure care costs, amounts subject to judgments under litigation and other long-term obligations are recorded only they mature (when the payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available financial resources are recorded in the government-wide financial statements but not in the governmental funds.

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- Executory purchase orders and contracts are recorded as a reservation of fund balance.

Liabilities outside the bounds of these exceptions or modifications are reported as governmental fund liabilities when incurred (including salaries, professional services, supplies, utilities, etc.) since these liabilities normally are paid in a timely manner and in full from current financial resources.

The measurement focus of the GFFS is on decreases in net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are not recognized in the accompanying GFFS.

Under the new financial reporting model established by GASB No. 34, all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are no longer reported in account groups within the governmental fund balance sheet but are now incorporated into the GWFS.

f) Stewardship, Compliance and Accountability

Budgetary Control

According to the Autonomous Municipalities Act of the Commonwealth of Puerto Rico, the Mayor and its Administrative Cabinet prepare each fiscal year an annual budget for the Municipality's general fund and debt service fund. Such legally adopted budget is based on expected expenditures by program and estimated resources by source for both funds. The annual budget is developed using elements of performance-based program budgeting and zero-based budgeting, and includes an estimate of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budget is prepared.

The Mayor must submit an annual budgetary resolution project (the project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 15, respectively. The Commissioner preliminarily verifies that the project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 13.

The Municipal Legislature has 10 business days up to no later than June 13 to discuss and approve the project with modifications. The Municipal Legislature may amend the budget submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approve the project, the modified project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Mayor may also veto the budget in its entirety and return it to the Municipal Legislature with his objections. If the project is rejected by the Mayor, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved project is sent again to the Mayor, which then would have 3 days to sign and approve it.

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If a budget is not adopted prior to the end of the deadlines referred to above, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve a new budget. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

The annual budget may be updated for any estimate revisions as well as year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budget, which is subject to the approval of the Municipal Legislature.

For day to day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. Appropriation control is by program within a fund. The Municipal Legislature may transfer amounts among programs within and between funds.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Budgetary Accounting

The Municipality's annual budget is prepared under the budgetary basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenue is generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

Under the budgetary basis of accounting, the Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at year-end. Other appropriations, mainly capital projects 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.

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g) Unrestricted and Restricted Deposits

The Municipality's deposits are composed of cash on hand and demand deposits in commercial banks and the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any excess is invested in certificates of deposit with original maturities of more than three months.

Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held in the Municipality's name by agents designated by the Secretary of the Treasury of the Commonwealth.

Restricted cash for major special revenue and capital projects funds, represent the balance of interest and noninterest bearing accounts restricted to finance the operations of federal and state funded programs and the acquisition and construction of major capital improvements, respectively.

Restricted cash in other governmental funds represents: (1) property tax collections retained and restricted for the payment of the Municipality's debt service, (2) resources restricted to finance the operations of all federal and state funded programs, and (3) resources restricted for the acquisition and construction of capital improvements.

h) Unrestricted and Restricted Accounts Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2003. Major receivable balances for the governmental activities include municipal license taxes, property taxes and intergovernmental receivables.

Tax receivables in the general fund represent uncollected property taxes and municipal license taxes. Tax receivables in the debt service fund consist of uncollected property taxes which are restricted for the payment of the Municipality's debt service, as established by law (see notes 3 and 4).

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to state and federally funded programs (recorded in the special revenue fund), and (2) other miscellaneous intergovernmental reimbursements and contributions.

These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable

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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 GFFS, 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.

i) Investments

Investments are composed of certificates of deposit with original maturities exceeding three months but not exceeding one year. Investments are held with commercial banks and are recorded at cost (which approximate fair value).

j) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying GWFS. Infrastructure assets are generally immovable in nature and include roads, bridges, streets and sidewalks, systems and other similar assets. The Municipality has no collection of works of art nor historical treasures.

The Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with a useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the government-wide statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure and certain land, buildings, structures and building improvements constructed or acquired prior to June 30, 2002. The method to deflate the current costs using an approximate price index was used only in the case of certain items for which their historical cost documentation was not available. Actual historical costs were used to value the infrastructure, land, building, structures, building improvements, construction in progress, machinery and equipment and licensed vehicles constructed or acquired during the year ended June 30, 2003.

Major outlays for capital assets and improvements are capitalized in the GWFS as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

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Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

| | |
|---|----------|
| Land improvements | 20 |
| Buildings, structures and building improvements | 50 |
| Infrastructure | 20 to 50 |
| Motor vehicles | 8 |
| Furniture and fixtures | 5 to 20 |
| Machinery and equipment, excluding those held under capital leases | 5 to 20 |

Depreciation and amortization expense on capital assets are recorded as direct expenses of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but reported as direct expenses of the urban and economic development function.

k) Deferred Revenues

The Municipality reports deferred revenue on its GFFS and GWFS. In the GFFS, deferred revenue arises when:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days thereafter to pay obligations due at June 30, or;
- Resources are received by the Municipality before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

l) Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time

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off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the government-wide statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2003, and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences, include salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security taxes, Medicare taxes, employer contributions to the employees' retirement systems and others).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year). Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Compensatory time is accumulated by employees at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave days is not paid to the employee. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employees at any time.

The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only if they have matured, for example, as a result of employee resignations and retirements.

m) Long-term Debt

The long-term liabilities reported in the GWFS include the Municipality's general obligation and public improvements bonds, long-term notes, obligation under capital leases, compensated absences, and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the government-wide statement of net assets, except for principal and interest payment on bonds due in July 1 of the following fiscal year, which is recorded in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, long-term debt is generally not reported as liabilities. The face amount of the debt issued is reported as other financing sources.

In the GWFS debt issuance costs are reported as deferred charges and are amortized under the straight-line method over the life of the debt while in the GFFS are recognized as expenditures as during the current period.

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On July 1, 2002, the Municipality adopted the provisions of APB Opinion No. 21, *Interests on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to the Puerto Rico Treasury Department (see note 7). According to APB No. 21, the Municipality has recorded these notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, this note payable is reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the note. The note discount is amortized over the life of the note using the effective interest method. Amortization of the note discount is recorded as part of interest expense in the statement of activities. In the GFFS, note discounts are recognized as other financing uses during the current period.

n) *Accounting for Pension Costs*

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, the two retirement systems in which the employees of the Municipality participate. Accordingly, the Municipality is considered a participant and not a sponsor of these retirement systems since substantially all of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth of Puerto Rico. Accordingly, no portion of the net pension obligation (NPO) related to ERS and System 2000 has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico accounts for the total amount of the net pension obligation of ERS and System 2000, including any amount that may be allocated to the Municipality.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions. In the GFFS the statutory contributions and the related liability are accounted for under the modified accrual basis of accounting while in the GWFS, are recorded under the accrual basis of accounting.

o) *Risk Management*

The Municipality carries commercial insurance covering casualty, theft, tort claims, and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all of municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center (known as "CRIM", by its Spanish Acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

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The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (known as "AACA", by its Spanish Acronyms), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to AACA.

The Municipality provides workers' compensation insurance coverage to its employees through the State Insurance Fund Corporation, a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality provides unemployment compensation, non-occupational disability, and drivers' insurance coverage to its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a quarterly basis.

The Municipality also provides medical insurance coverage to all employees. The current insurance policies have not been canceled or terminated at June 30, 2003. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

p) Reservations of Fund Balances

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

- ***Encumbrances*** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- ***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.
- ***Debt Service*** – Represent fund balances available to finance future debt service payments.
- ***Other Specified Purposes*** – Represents resources set aside for use under federal and state grant programs accounted for in special revenue funds.

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q) *Interfund Transactions*

Permanent reallocations of resources between the Municipality's funds are classified as interfund transfers. The Municipality has the following types of transactions recorded among funds in the GFFS:

- ***Operating Transfers*** – Represent legally required transfers that are reported when incurred as “operating transfers-in” by the recipient fund and as “operating transfer-out” by the disbursing fund.
- ***Intra-Entity Transactions*** – Represent transfers between the funds of the Municipality that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- ***Advances*** – Represent the amounts advanced among the funds of the Municipality, which are not considered to be currently available financial resources.

r) *Use of Estimates*

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

s) *Future Adoption of Accounting Pronouncements*

The GASB issued GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units* (GASB No. 39), which is effective for the fiscal year beginning on July 1, 2003. The Municipality has not adopted the requirements of this statement at June 30, 2003.

DEPOSITS

The Municipality maintains its deposits of cash in the Government Development Bank for Puerto Rico (“GDB”) (a governmental bank and component unit of the Commonwealth) which serves as fiscal agent of the Municipality; and in various commercial banks located in Puerto Rico. The balances deposited in GDB are uninsured and uncollateralized. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to a maximum of \$100,000 per depositor. However, under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance provided by the FDIC. All securities pledged as collateral are held by an agent of the Secretary of the Treasury of the Commonwealth in the name of the Municipality.

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Cash, cash equivalents and investments at June 30, 2003 consist of the following:

| | <u>Included in General Fund</u> | <u>Included in Debt Service Fund</u> | <u>Included in FEMA Georges</u> | <u>Included in Joint Resolutions</u> | <u>Included in Other Governmental Funds</u> | <u>Total</u> |
|---|---|--|---|--|---|---------------------|
| Unrestricted cash and cash equivalents in commercial bank | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Temporarily restricted cash and cash equivalents | - | 344,723 | 723,815 | 367,661 | 469,040 | 1,905,239 |
| Total | \$ - | \$ 344,723 | \$ 723,815 | \$ 367,661 | \$ 469,040 | \$ 1,905,239 |

The Municipality's bank balance of deposits and investments with financial institutions are categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2003. Risk categories are described as follows:

- Category 1:** Insured or collateralized with securities held by the Secretary of the Treasury's agents in the Municipality's name.
- Category 2:** Collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.
- Category 3:** Uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
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The carrying amount (book balance) and the bank balance of deposits and investments with financial institutions of the Municipality at June 30, 2003 consist of the following:

| | Carrying Amount | Bank Balance |
|--|----------------------------|-------------------------|
| Deposits in commercial banks | \$ 836,701 | \$ 889,226 |
| Deposits in governmental banks | 1,068,538 | 1,069,509 |
| Total | \$ 1,905,239 | \$ 1,958,735 |
| Bank balances of deposits and investments: | | |
| Category 1 | | \$ 889,226 |
| Category 2 | | - |
| Category 3 | | 1,069,509 |
| Total bank balances | | \$ 1,958,735 |

MUNICIPAL LICENSE TAXES

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 Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. At June 30, 2003, the municipal tax rates imposed by the Municipality were 1.50 percent for financing institutions and 0.30 percent for any other taxpayers. Any taxpayers, who have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth, ultimately pay municipal license taxes at reduced tax rates, generally between 60 and 90 percent under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her municipal license through a tax return every April 15 based on the actual municipal license generated in the preceding calendar year. The tax can be paid by the taxpayer in two equal installments: (1) the first payment due at the filing date of the return (generally April 15), and (2) January 15 subsequent to the filing of the declaration. The first installment of the tax covers the taxable period (six months) ended December 31 subsequent to the filing date of the declaration, while the second installment of the tax covers the taxable period (six months) ended June 30 of the subsequent calendar year. If the taxpayer elects to pay the tax in full on the filing date of the tax return (April 15), a 5 percent discount is granted automatically on the tax amount due.

Any municipal license taxes collected in advance (that is, prior to June 30 but pertaining to the next fiscal year) are recorded as deferred revenues. As of June 30, 2003, the total municipal license tax receivable (net of the allowance for estimated uncollectible amounts) and the respective deferred revenues amounted to \$15,951 and \$151,761 respectively, in the accompanying government-wide financial statements.

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June 30, 2003

PROPERTY TAXES

The Municipality is authorized by law to impose and collect personal and real property taxes. Personal property taxes can be imposed to any natural or legal person engaged in trade or business that at January 1 of each year is owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. At June 30, 2003, the total personal property tax rate in force was 6.03 percent (of which taxpayers pay 5.83 percent and .20 percent is reimbursed by the Department of Treasury of the Commonwealth). Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated at 1957 market prices. At June 30, 2003, the total real property tax rate in force was 8.03 percent (of which 7.83 percent is paid by taxpayers).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury of the Commonwealth assumes payment of the basic tax (4.00 and 6.00 percent for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the general fund when collections are received from the CRIM.

CRIM is required to remit 1.03 percent of the personal and real property tax collected to the Municipality to be used for the partial funding of the debt service requirements on general obligations and notes payable of the Commonwealth of Puerto Rico. In addition, 1.00 percent of the total personal and real property taxes collected by CRIM is restricted for debt service requirements of the Municipality and is retained by GDB for such purposes. Accordingly, such amount is recorded as revenues in the debt service fund when collected and reported by the CRIM.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth of which a fixed amount of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35 percent corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations

COMMONWEALTH OF PUERTO RICO
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from the municipalities' Puerto Rico Health Reform is covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

INTERFUND BALANCES

On July 1, 2001 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures, issued by the Governmental Accounting Standards Board*. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2003 consisted of the following:

| | <u>Operating Transfer from:</u> | | | | | | <u>Total</u> |
|--------------------------------|---------------------------------|-------------------|----------------|--------------------|----------------|----------------|-------------------|
| | <u>Major Funds</u> | | | | <u>Special</u> | <u>Other</u> | |
| <u>Operating Transfers to:</u> | <u>General</u> | <u>Debt</u> | <u>FEMA</u> | <u>Joint</u> | <u>Revenue</u> | <u>Capital</u> | |
| | <u>Fund</u> | <u>Service</u> | <u>Georges</u> | <u>Resolutions</u> | <u>Fund</u> | <u>Project</u> | |
| | | <u>Fund</u> | <u>Funds</u> | | | <u>Funds</u> | |
| Major funds: | | | | | | | |
| General fund | \$ - | \$ 182,250 | \$ - | \$ - | \$ - | \$ - | \$ 182,250 |
| Debt service fund | - | - | - | - | - | - | - |
| Joint resolutions | - | - | - | - | - | - | - |
| Nonmajor funds: | | | | | | | |
| Special revenue fund | - | - | - | - | - | - | - |
| Other capital projects fund | - | - | - | - | - | - | - |
| Total | <u>\$ -</u> | <u>\$ 182,250</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 182,250</u> |

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COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
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| Due To: | Major Funds | | | | | | Other Capital Project Funds | Total |
|-----------------------|------------------|-------------------------|-----------------|----------------------|----------------------------|-------------|--------------------------------------|---------------------|
| | General Fund | Debt Service Fund | FEMA Georges | Joint Resolutions | Special Revenue Fund | Total | | |
| Major funds: | | | | | | | | |
| General fund | \$ - | \$ - | \$ - | \$ 1,015,422 | \$ 867 | \$ - | \$ - | \$ 1,016,289 |
| Debt service fund | 468 | - | - | - | - | - | - | 468 |
| Fema George | | | | | | | | |
| Joint Resolution | - | - | - | - | 6,881 | - | - | 6,881 |
| Nonmajor funds: | | | | | | | | |
| Special revenue fund | 107,198 | - | - | - | - | - | - | 107,198 |
| Capital projects fund | - | - | - | - | - | - | - | - |
| Total | <u>\$107,666</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 1,015,422</u> | <u>\$ 7,748</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 1,130,836</u> |

At June 30, 2003 all amounts due to among funds are considered collectible by the Municipality's management.

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COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
June 30, 2003

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003, was as follows:

| | Balance at June 30, 2002, as restated | Additions | Reclassifications | Balance at June 30, 2003 |
|--|--|---|-------------------|--------------------------------|
| COST BASIS: | | | | |
| Cost basis of capital assets, not subject to depreciation and amortization: | | | | |
| Infrastructure land | \$ 1,098,113 | \$ - | \$ - | \$ 1,098,113 |
| Construction in progress | - | - | - | - |
| Total cost basis of capital assets, not subject to depreciation and amortization | <u>1,098,113</u> | <u>-</u> | <u>-</u> | <u>1,098,113</u> |
| Cost basis of capital assets, subject to depreciation and amortization: | | | | |
| Buildings, structures and building improvements | 4,011,299 | | | 4,011,299 |
| Infrastructure | 846,300 | | | 846,300 |
| Land Improvements | 518,974 | | | 518,974 |
| Licensed vehicles | 1,383,854 | 43,060 | - | 1,426,914 |
| Machinery and equipment | 253,888 | 7,310 | - | 261,198 |
| Equipment under capital leases | | | | |
| Total cost basis of capital assets subject to depreciation and amortization | <u>7,014,315</u> | <u>50,370</u> | <u>-</u> | <u>7,064,685</u> |
| Total cost basis of capital assets | <u>\$ 8,112,428</u> | <u>\$ 50,370</u> | <u>\$ -</u> | <u>\$ 8,162,798</u> |
| | Balance at June 30, 2002 | Depreciation and Amortization Expense | Reclassifications | Balance at June 30, 2003 |
| ACCUMULATED DEPRECIATION AND AMORTIZATION: | | | | |
| Buildings, structures and building improvements | \$ 1,113,428 | \$ 72,203 | - | \$ 1,185,631 |
| Infrastructure | 761,670 | - | - | 761,670 |
| Land Improvements | 330,229 | 23,747 | - | 353,976 |
| Licensed vehicles | 928,696 | 135,246 | - | 1,063,942 |
| Machinery and equipment | 136,878 | 17,479 | - | 154,357 |
| Equipment under capital leases | | | | |
| Total accumulated depreciation and amortization | <u>3,270,901</u> | <u>248,675</u> | <u>-</u> | <u>3,519,576</u> |
| CAPITAL ASSETS, NET | <u>\$ 4,841,527</u> | <u>\$ (198,305)</u> | <u>\$ -</u> | <u>\$ 4,643,222</u> |

Depreciation and amortization expense was charged to functions in the accompanying government-wide statement of activities as follows:

| | |
|---|-------------------|
| General government | \$ 15,400 |
| Public safety | 19,526 |
| Economic Development | 117,302 |
| Culture and recreation | 70,411 |
| Sanitation | 6,188 |
| Health | 6,496 |
| Welfare and public housing | <u>13,352</u> |
| Total depreciation and amortization expense | <u>\$ 248,675</u> |

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
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EMPLOYEES RETIREMENT SYSTEM

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act No. 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants. The System issues public financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the Administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits are vested after 10 years of plan participation.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
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System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or later January 1, 2000.

Funding Policy:

Contribution requirements are established by law and are as follows:

| | |
|-----------------------------------|--|
| Municipality | 9.275% of gross salary |
| Employees: | |
| Hired on or before March 31, 1990 | 5.775% of gross salary up to \$6,600 8.275 of gross salary over \$6,600 |
| Hired on or after April 1, 1990 | 8.275% of gross salary |

During the fiscal year ended June 30, 2003 the employer's contributions paid by the Municipality to both retirement systems amounted to \$228,837. On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years or services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, the Commonwealth will assume any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

LONG-TERM DEBT

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on

COMMONWEALTH OF PUERTO RICO
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account of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the 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 or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2003, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2003 was as follows:

| | Balance at June 30, 2002, as restated | Borrowings or Additions | Payments or Deductions | Other net changes | Balance at June 30, 2003 | Due Within One Year |
|-------------------------------|---|----------------------------|---------------------------|----------------------|--------------------------------|------------------------|
| Bonds payables | \$ 2,030,000 | | \$(185,000.00) | | \$ 1,845,000 | \$ 205,000 |
| Property tax advance (Law 42) | 3,814,820 | | (63,762) | | 3,751,058 | 19,498 |
| Dept. de Hacienda (15 years) | 205,517 | | (18,549) | | 186,968 | 46,570 |
| Loan Payable (Law 146) | | \$ 83,620 | | | 83,620 | 1,268 |
| Compensated absences | 1,000,608 | | (5,638) | | 994,970 | |
| Claims and judgments | 277,000 | | (277,000) | | | |
| Total | \$ 7,327,945 | \$ 83,620 | \$ (549,949) | | \$ 6,861,616 | \$ 272,336 |

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Long-term debt at June 30, 2003 is composed of the following debts:

General Obligation Bonds:

| | <u>Outstanding Amount</u> |
|---|--------------------------------------|
| 1998 serial bonds due in annual principal installments ranging from \$ 50,000 to \$60,000; plus interest due in semiannually installments at variable rates (5.19% to 5.29% at June 30, 2003) through July, 1, 2005 | \$ 115,000 |
| 1999 serial bonds due in annual principal installments ranging from \$ 35,000 to \$50,000; plus interest due in semiannually installments at variable rates (2.70% to 3.21% at June 30, 2003) through July, 1, 2007 | 175,000 |
| 2000 serial bonds due in annual principal installments of \$ 5,000; plus interest due in semiannually installments at variable rates (5.00% to 8.00% at June 30, 2003) through July, 1, 2005 | 10,000 |
| | 300,000 |

Public Improvement Bonds:

| | |
|---|---------|
| 1998 serial bonds due in annual principal installments ranging from \$85,000 to \$130,000; plus interest due in semiannual installments at variable rates (5.00% to 6.50% at June 30, 2003) through July, 1, 2008 | 535,000 |
|---|---------|

COMMONWEALTH OF PUERTO RICO
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2002 serial bonds due in annual principal installments ranging from \$10,000 to \$440,000; plus interest due in semiannual installments at variable rates (5.00% to 6.50% at June 30, 2003) through July, 1, 2026

1,010,000
1,545,000

Loan Payable to the Dept. of Treasury:

2001 operating loan with the Department of Treasury due in monthly principal installments of \$2,367

186,968

Loan Payable to CRIM (Law 42):

2001 operating loan with the Department of Treasury due in monthly principal installments ranging from \$3,566 to \$23,358; which includes implicit interest due in monthly installments at 6.3% through July 1, 2033

3,751,058

Loan Payable Delinquent accounts (Law 146)

Municipal revenue Collection Center (CRIM) Prior Years property tax delinquent accounts expected to be refinanced through long-term debt.

83,620

Provision for accrued compensated absences

994,970

Total long-term debt \$ 6,861,616

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

| Year Ended 6/30 | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-----------------|---------------------|---------------------|---------------------|
| 2004 | \$ 205,000 | \$ 89,586 | \$ 294,586 |
| 2005 | 215,000 | 94,067 | 309,067 |
| 2006 | 170,000 | 83,190 | 253,190 |
| 2007 | 185,000 | 73,938 | 258,938 |
| 2008 | 150,000 | 64,675 | 214,675 |
| 2009 | 20,000 | 59,150 | 79,150 |
| 2010-2013 | 110,000 | 220,350 | 330,350 |
| 2014-2017 | 150,000 | 186,550 | 336,550 |
| 2018-2021 | 200,000 | 141,375 | 341,375 |
| 2022-2026 | 440,000 | 92,300 | 532,300 |
| Totals | <u>\$ 1,845,000</u> | <u>\$ 1,105,181</u> | <u>\$ 2,950,181</u> |

As described in Note 5, the Municipality levies an annual additional special tax of 1.00% of the assessed value of personal and real property. The proceeds of this additional special tax are required to be credited to the debt service fund for payment of general obligation bonds and notes of

COMMONWEALTH OF PUERTO RICO
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the Municipality. The property taxes are collected by CRIM as agent of the Municipality (see note 5).

7. ACCOUNTING CHANGES AND RESTATEMENTS

During current year, the Municipality implemented several new accounting standards and pronouncements issued by GASB.

GASB Statement No. 34, as amended by GASB 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the 2002 financial statements were required.

GASB Statement No. 38 requires certain note disclosures. The provisions of these new standards have been incorporated into the basic financial statements and notes.

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

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

The following schedule reconciles the June 30, 2002 fund balances as previously reported by the Municipality to the beginning fund balances, as restated:

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Notes to Basic Financial Statements
June 30, 2003

| | June 30, 2002, Fund Balance as previously reported | Reclassifications and Adjustments | June 30, 2002, Fund Balance as restated |
|-----------------------------|---|--------------------------------------|---|
| Major funds: | | | |
| General fund | \$ (1,934,615) | \$ 893,487 | \$ (1,041,128) |
| Debt service fund | 218,434 | (100,260) | 118,174 |
| Hurricane Georges | 511,816 | 4,888 | 516,704 |
| Joint resolutions | 1,301,750 | 96,875 | 1,398,625 |
| | <u>97,385</u> | <u>894,990</u> | <u>992,375</u> |
| Nonmajor funds: | | | |
| Special revenue fund | 115,095 | (38,773) | 76,322 |
| Other capital projects fund | 162,115 | - | 162,115 |
| | <u>277,210</u> | <u>(38,773)</u> | <u>238,437</u> |
| Totals | <u>\$ 374,595</u> | <u>\$ 856,217</u> | <u>\$ 1,230,812</u> |

The following table reconciles certain liabilities reported in the June 30, 2002 general long-term debt account group (GLTDAG) the respective beginning long-term liabilities balances in the accompanying statement of net assets, as restated:

| | June 30, 2002, GLTDAG balance as previously reported | Reclassifications and Adjustments | June 30, 2002, liabilities balances of statement of net assets, as restated |
|---------------------------|---|--------------------------------------|---|
| P. R. Department of Labor | \$ 552,910 | \$ (552,910) | \$ - |
| Property tax advances | 4,138,772 | (323,952) | 3,814,820 |
| Dept. Hacienda (15 years) | 255,674 | (50,157) | 205,517 |
| Compensated absences | 806,078 | 194,530 | 1,000,608 |
| Totals | <u>\$ 5,753,434</u> | <u>\$ (732,489)</u> | <u>\$ 5,020,945</u> |

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
YEAR ENDED JUNE 30, 2003

| | Budgeted Amounts | | Actual Amounts (Budgetary Basis) (See Note 1) | Variance with Final Budget - Positive (Negative) |
|--|---------------------|---------------------|---|---|
| | Original | Final | | |
| Revenues: | | | | |
| Property taxes | \$ 3,263,241 | \$ 3,263,241 | \$ 3,268,561 | \$ 5,320 |
| Volume of business tax, licenses and Permits | 248,671 | 248,671 | 193,352 | (55,319) |
| Intergovernmental revenues | 420,530 | 420,530 | 420,033 | (497) |
| Rent of property | 84,000 | 84,000 | 18,404 | (65,596) |
| Interest | 350,500 | 350,500 | 279,228 | (71,272) |
| Miscellaneous | 822,500 | 822,500 | 792,591 | (29,909) |
| | <u>\$ 5,189,442</u> | <u>\$ 5,189,442</u> | <u>\$ 4,972,169</u> | <u>\$ (217,273)</u> |
| Expenditures: | | | | |
| General government | \$ 2,546,315 | \$ 2,554,946 | \$ 2,191,170 | \$ 363,776 |
| Public safety | 232,974 | 244,459 | 227,938 | 16,521 |
| Economic Development | 1,606,730 | 1,637,531 | 1,599,511 | 38,020 |
| Culture and recreation | 204,673 | 171,733 | 151,750 | 19,983 |
| Sanitation | 84,000 | 84,000 | 63,790 | 20,210 |
| Health | 424,080 | 411,180 | 409,014 | 2,166 |
| Welfare and housing | 90,670 | 85,594 | 83,587 | 2,007 |
| | <u>\$ 5,189,442</u> | <u>\$ 5,189,443</u> | <u>\$ 4,726,760</u> | <u>\$ 462,682</u> |

Explanation of Differences:

Sources/inflows of financial resources:

| | |
|---|---------------------|
| Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule | \$ 4,972,169 |
| Differences - budget basis to GAAP: | |
| Adjustments to receivables to convert to modified accrual basis | 8,635 |
| Resources considered revenues for budgetary purposes but are not revenues for financial reporting purposes | (1,028,375) |
| Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds | <u>\$ 3,952,429</u> |

Uses/outflows of financial resources:

| | |
|---|---------------------|
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | \$ 4,726,760 |
| Differences - budget basis to GAAP: | |
| Adjustments to payables to convert to modified accrual basis | (138,688) |
| Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes | (182,250) |
| Outflows of budgetary resources used for financing expenditures that are not expenditures for budgetary purposes | 168,045 |
| Resources considered expenditures for budgetary purposes but are not expenditures for financial reporting purposes | (163,822) |
| Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds | <u>\$ 4,410,045</u> |

The accompanying notes to the basic financial statements are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
Notes to Basic Financial Statements
June 30, 2003

NOTE 10 – FIXED ASSETS VALUATION METHOD

According to the consultant contracted by the municipality to updated the fixed assets ledger, its utilizes generally accepted appraisal practices when providing valuation conclusions. All of they appraisal conclusions are prepared in accordance with the stringent requirements of the Uniform Standards of Professional Appraisal Practice (USPAP) and are designed to assist in compliance with various state accounting mandates, GAAP, GASB 34/35, OMB, GAAFR, and insurance underwriting requirements.

The valuation and costing procedures include the use of various research sources to develop cost conclusions for each asset or group of assets. These sources include catalogs, phone quotes, price list, trade journals, industry publications, proprietary databases, manufacture's price quotations, technical pricing subscription services and engineering and costing manuals such as Means, Marshall Swift, Handy whitman, and E.H. Boeckh. To determine original cost utiizing one or more of the costing methods as described below:

Direct Costing – Inventoried units/groups will match a historical cost record and will be recorded at that amount, if possible.

Standards Costing- Inventoried property units/groups not reconciled to a historical record will receive an estimated cost, where possible, based on a Standard Cost (a known average installed cost for a like nit – estimating acquisition date). The unit's age is estimated based on observed condition, manufacturer's name, model, serial number, age of the facility, etc.

Normal Costing – Where neither of the above techniques can be employed to apply historical cost, cost is estimated based on a present Cost of Reproduction New (also known as "Replacement Cost") indexed by a reciprocal factor of the price increase from the estimated date acquired to the appraisal date. This is the most common method used by the consultant contracted (appraisals) ans was likely used for valuing the majority of the infrastructure assets.

In summary, where original cost records were not available they appraisal team estimated the replacement cost using the sources mentioned earlier, and calculated the original costs using a reciprocal factor taking into consideration the asset's class, acquisition date, and replacement cost.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO

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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

| FEDERAL GRANTOR/PASS THROUGH GRANTOR PROGRAM TITLE | FEDERAL CFDA NUMBER | <u>EXPENDITURES</u> |
|---|---------------------------|--------------------------|
| US DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT | | |
| Direct Programs: | | |
| Section 8 Vouchers and Portability | 14.855 | \$ 162,987 |
| Indirect Program: | | |
| State Block Grant Program (SBGP) | 14.228 | <u>323,135</u> |
| Total US Department of Housing and Urban Development | | <u>486,122</u> |
| US DEPARTMENT OF HEALTH AND HUMAN SERVICES | | |
| Child Care | N/A | <u>152,778</u> |
| DEPARTMENT OF JUSTICE | | |
| Passed through Commonwealth of PR Department of Justice | | |
| Local Cops | 16.710 | 47,090 |
| U.S. Federal Emergency Management Agency Public Assistance Grants (FEMA) | 83,545 | |
| State and Local Assistance | | <u>158,243</u> |
| TOTAL FEDERAL FINANCIAL ASSISTANCE | | <u>\$ 844,233</u> |

The accompanying notes are integral part of the financial statements.
See auditor's report.

MUNICIPALITY OF MARICAO, PUERTO RICO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2003

NOTE 1. GENERAL

The accompanying Schedule of Expenditures of Federal Awards presents balance expended of all Federal Financial Assistance Programs of the Municipality of Maricao, Puerto Rico. The reporting entity is defined in Note 1 to the general-purpose financial statements.

NOTE 2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Federal financial assistance revenues and expenditures are reported in the Municipality's general-purpose financial statements as other governmental funds and capital project fund.

NOTE 3. FEDERAL CFDA NUMBER

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

***REPORT ON COMPLIANCE AND 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 Assembly
Municipality of Maricao
Maricao, Puerto Rico

I have audited the financial statements of the Municipality of Maricao as of and for the year ended June 30, 2003, and has issued my report thereon dated December 30, 2003. I conducted my audit in accordance with generally accepted auditing standards 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 Maricao financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs Section III.

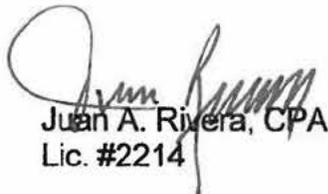
Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Municipality of Maricao internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the Municipality of Maricao ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs Section II.

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 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. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness. However, I believe that none of the reportable conditions described above is a material weakness.

This report is intended for the information of the audit committee, the Municipality's management, the Department of Housing and Urban Development (Cognizant Agency), and federal awarding agencies and pass-through entities and not is intended to be and should not be used by anyone other than these specified parties.


Juan A. Rivera, CPA
Lic. #2214

December 30, 2003
Toa Baja, Puerto Rico

Stamp NO. 1931656 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report

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

To the Honorable Mayor and
the Municipal Assembly
Municipality of Maricao
Maricao, Puerto Rico

Compliance

I have audited the compliance of Municipality of Maricao with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2003. The Municipality of Maricao 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 Comercio management. My responsibility is to express an opinion on the Municipality of Aibonito compliance based on my audit.

I conducted my audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Governmental Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those Standards and OMB Circular A-133 require that I 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 Maricao compliance with those requirements and performing such other procedures as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not include a legal determination of the Municipality of Maricao compliance with those requirements.

As described in item Section III in the accompanying schedule of findings and questioned costs, the Municipality of Maricao did not comply with requirements regarding administrative requirements that are applicable to its Section 8 Program. Compliance with such requirements is necessary, in my opinion, for the Municipality of Maricao to comply with the requirements applicable to that program.

In my opinion, except for the noncompliance described in the preceding paragraph, the Municipality of Maricao complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003.

Internal Control Over Compliance

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

I noted certain matters involving the internal control over compliance and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in my judgment, could adversely affect the Municipality of Maricao ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs in Section II and III.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

However, I believe that none of the reportable conditions described above is a material weakness. This report is intended for the information of the audit committee, the Municipality's management, the Department of Housing and Urban Development (Cognizant Agency), and federal awarding agencies and pass-through entities. However, this report is not intended to be and should not be used by anyone other than these specified parties.



Juan A. Rivera, CPA
Lic. #2214
December 30, 2003

NOTE: Stamp No. 1931657 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

REPORTABLE CONDITIONS

FINDING NUMBER 03-01

Accounting System

I noted that the Municipality of Maricao is not keeping an accounting system as required by General Accepted Accounting Principles at present time, the Municipality records the transactions in the general, capital project and special funds. These funds are kept under the cash basis method. Also, the system used to record the purchased orders and contracts are not adequate; because does not provide for a segregation between the account payable and the encumbrances. In order to prepare the combined financial statements, we realized several adjusting entries to convert them to a modified accrual basis of accounting.

Recommendation

I recommend the Municipality of Maricao that in coordination with the Municipal Revenue Collection Center and the Commissioner Office of Municipal Affairs, implement an accounting system which should provide the following.

That the Municipality's operations are accounted for through several separate funds and account groups, accounting in each of them the related assets, liabilities, and equity and other balances. The individual funds should be summarized in a combined financial statements by fund category. The Municipality should use the general purpose financial statements based on the following fund and accounts groups:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

REPORTABLE CONDITIONS – (Continued)

Accounting System – (Continued)

a. Governmental Funds

Governmental funds are used to finance most of the governmental functions. The sources and uses of resources available are systematically registered through the statement of changes in fund balances and not through the determination of net income. The different types of governmental funds are as follows:

- 1) General
This is the operational fund for the Municipality. It accounts for all financial resources except those required to be accounted for in another funds.
- 2) Special Revenue
Is used to account for the proceeds of specific revenue sources (other than expendable trust or mayor capital projects) that are legally restricted for expenditure for specific purposes.
- 3) Debt Service
Is used to account for the accumulation of resources for, and the payment of, general long term debt, principal, interest and, related costs.
- 4) Capital Project
Is used to account for financial resources to be used for the construction or acquisition of major capital facilities (other than those financed by proprietary and trust funds).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

REPORTABLE CONDITIONS – (Continued)

Accounting System – (Continued)

The resources that come from bonds and notes are registered as other financial resources in the Capital Project Funds. The expenditures related to the projects are incurred after the bonds and note issuances.

So, the Capital Project Funds can reflect an excess of expenditures over revenues and other resources.

b. Proprietary Fund

Is used to account for operations financed and operated similar to business, whose main objective is the determination of net income. The main objective of this type of fund is to match income with expenses and deriving profits. Depreciation Accounts are also used in this type of fund.

c. Trust and Agency Fund

Is used account for assets held by the Municipality Agency, in the trustee's capacity or as agent whose main responsibility is to ascertain that those assets are disposed of as prescribed by the individual or other governmental unit.

d. Account Groups

Accounts groups are not funds. The same should be used to establish accounting controls and to account for General Fixed Assets and General Long- term Debt.

1) General Fixed Assets account group

Is used to provide accounting over general fixed assets, except those already recorded in the proprietary and Trust Funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

REPORTABLE CONDITIONS – (Continued)

Accounting System – (Continued)

d. Accounts Groups

2) **General Long-term Debt accounts group**

Is used to provide accounting control over General Municipal Long-term Debt; except those accounted in the Proprietary and Trust Funds.

The Municipality's accounting system should provide for the segregation of the encumbrances from accounts payable. Encumbrances represent commitments related with a service to be received or a good to be acquired. This amount should be accumulated in an account named Fund Balance Reserved for Encumbrances at the time the purchase order is issued. The amount of Encumbrances should be reserved for each fund balance since no bilateral agreement exists. The accounts payable and expenses should be recorded when the debt is incurred and the amount is determinable.

Auditee Response:

The government agency known as "OCAM" who is in charge of the accounting system of the municipalities is evaluating, the actual system with the intention of perhaps changing to another system. The Municipality is awaiting instructions from such agency.

FINDING NUMBER 03-02

Bank Accounts and Cash Management

Condition

At June 30, 2003, some bank reconciliations showed overdraft and unreconciliation items without explanation (previous years) and necessary book adjustment.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

REPORTABLE CONDITIONS – (Continued)

FINDING NUMBER 03-02 – (Continued)

Bank Accounts and Cash Management – (Continued)

| | |
|----------------------------|--|
| Criteria | The chapter IV sections 9 and 10 of “reglamento de normas basicas para los municipios de PR” stated; <ul style="list-style-type: none">a. The municipality must know the available Bank Balance in all bank accounts.. |
| Cause of condition | The Municipality has not established sufficient controls in the handling of bank accounts to prevent errors and irregularities from being timely detected. In addition, the Municipality has not established effective cash management controls. |
| Effect of condition | E-rror or irregularities might occur and not be timely detected. |
| Recommendation | All bank accounts must be reconciled every month and all reconciling differences if any, must be investigated and adjusted accordingly. |
| Auditee Response: | Director of finance instructed the employee in charge of bank conciliation to analyzed all differences in bank conciliation and prepared the necessary adjustment before second quarter of next year. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

REPORTABLE CONDITIONS – (Continued)

FINDING NUMBER 03-3 – (Continued)

Purchasing and Receiving- (Continued)

Condition

My review of thirty five (35) disbursement vouchers for municipality general fund revealed noncompliance with applicable internal control requirements. My review of the supporting documentation revealed the following documents were missing or incomplete:

| Description | Municipality <u>Funds</u> |
|--|--------------------------------------|
| a Quotation not found | 1 |
| | <u>Special Funds</u> |
| a. Not evidence of pre-audit for payment | 1 |
| b. Not description of source for payment | 1 |
| c. Invoice was received before service Rendered. | 1 |
| d. Diferents P.O. for the same capital project or construction, instead of one P.O. for the total project. | 1 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

FINDING NUMBER 03-03-(Continued)

Purchasing and Receiving (Cont.)

Criteria

The plan of organization and methods and procedures adopted by an entity shall ensure that the use of resources is consistent with laws, regulations and polices. The above described conditions are contrary to the following regulations:

- a. Law No. 81 dated August 30, 1991
- b. Attachment L of the PROMB circular de 54-84 G 54-84

Such regulation establish among other things that:

- a. A financial management system shall provide for an effective control over and accountability for all funds, properties, and an other funds.
- b. A grantee financial management system shall provide for procedures for determining reasonableness, allocability and allowability of costs in accordance with the provisions of state regulations and OMB Circular A-87.

Cause of condition

The Municipality ha not established the necessary procedures to comply with the purchasing and receiving procedures.

Effect of condition

The Municipality did not comply with the regulation mentioned above.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

FINDING NUMBER 03-03-(Continued)

Purchasing and Receiving (Cont.)

Recommendation

The Municipality should reengineer its purchasing process taking into account the applicable laws. And regulations applicable. As part of the mechanization process, the Municipality should evaluate an accounting system that integrates the purchasing function.

Auditee Response:

The mayor instructed the director of finance to enforce the current disbursement procedure immediately to avoid this situation in the future.

FINDING NUMBER 03-04

Revenues / Accounts Receivable

Condition

The following deficiencies were found in the revenue and accounts receivable area:

- a. 2 of 25 taxpayer file did not have evidence of income tax return.
- b. 1 of 25 did not comply with the information required for gasoline station.
- c. 2 of 25 did not comply with schedule N, related to rent income.

Criteria

The Municipality ' s control over revenues shall ensure that the data obtained from the system be reliable and that adequate controls be in force over the levy and / or collection of taxes and accounts receivable.

**MUNICIPALITY OF MARICAO
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 FISCAL YEAR ENDED JUNE 30, 2003
 SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
 QUESTIONED COSTS**

FINDING NUMBER 03-04 – (Continued)

Revenues / Accounts Receivable – (Continued)

| | |
|-----------------------------|--|
| Criteria (Continued) | In addition, the Municipality must maintain adequate controls over volume of business taxes receivable and shall establish an effective system of accounts receivable recording. |
| Cause of condition | This situation cause that the data that could be obtained from the system be unreliable and that the Municipality does not have a good control over the levy and / or collection of taxes. |
| Effect of condition | The amount of volume of business tax receivable were not properly documented. |
| Recommendation | The Municipality must establish the necessary procedures to have in place a computerized system to levy the volume of business tax and record accounts receivable and use this data in the collection process. |
| Auditee Response | The mayor gave instruction to the municipality collectors, that immediately do not process any volume of business return without the documentation required by law. |

FINDING NUMBER 03-5

Personnel Files

Condition My review of fifteen (25) personnel files for the year under audit, revealed the following instances where the required documents, were not found:

| | |
|-------------------------|--------------------------|
| <u>Documents</u> | <u>Exceptions</u> |
|-------------------------|--------------------------|

- | | |
|--|----|
| a. Governmental ethic law were discussed with the employees | 25 |
| b. Not evidence of employee performance evaluation. | |

**MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

FINDING NUMBER 03-5

Personnel Files

Condition (Continued)

c. In 3 of 25 were not found the distribution of the municipal police related to Drug Abuse.

Criteria

Deviations from these requirements are contrary to Article 12.006 of the Law No. 18 dated August 30, 1991.

The Municipality should provide adequate procedures for determining reasonableness, allocability and allowability of costs in accordance with State regulations and the provisions of OMB Circular A-87. Furthermore, Attachment B, Section 10 of OMB Circular A-87 establishes that amounts charged to grant programs for personal services will be based on payrolls documented and provided in accordance with generally accepted practices of the State. Payroll must be supported by time and attendance records for individual employees.

Criteria

The payroll cost is allowable to the extent that compensation for individual employees follows an appointment made in accordance with State laws and regulations.

Furthermore, federal regulations state that financial records, supporting documents statistical records and all other records pertinent to a grant shall be retained for a period of three years, subject to certain qualifications. This retention period starts from the date of the submission of the final expenditure report or from the date of the submission of the annual financial status report.

**MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

FINDING NUMBER 03-5

Personnel Files –(Continued)

Criteria (Continued)

In addition, the federal government requires compliance with general requirements such as Davis – Bacon act, civil rights, political activity and allowable costs and cost principles.

Cause of condition

The Municipality did not comply with Governmental Ethic Law and police of drug abuse; fail in give written instructions of its employees.

Effect of condition

The Municipality did not comply with the Article 12.006 of the Law No. 81 dated August 30, 1991. In addition, payroll costs incurred not properly supported could be disallowed.

Recomendation

The municipality management will instruct the personell director to give orientation to employe related to ethical law and police of drug abuse; also this orientation will be documented and file in each employee record.

Auditee Response

The Mayor gave instructions to the personnel director to included in all employees record the evidence of ethical law were discussed. (Seminar relate to ethical law was given to all employees)

FINDING NUMBER – 03-06

Bids

Condition

As part of my examination of the bids procedures of the Municipality, I requested the file and documents for ten (10) bids granted during the year. The following summarizes the deficiencies found:

- a. 1 of 10 the contract did not provided the social security number required bay income tax law.
- b. 3 of 10 the contract did not provided for the budget account from which the service will be pay.

**MUNICIPALITY OF MARICAO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2003**

**SECTION II. SCHEDULE OF FINANCIAL STATEMENTS FINDINGS AND
QUESTIONED COSTS**

FINDING NUMBER – 03-06 – (Continued)

Bids – (Continued)

- c. 3 of 10 the contract did not provided that the employee's did not have direct or indirect interest with the municipality.
- d. 3 of 10 the contract did not have the clause, that the person did not receive payment of other entity.

Criteria

Those situations are contrary to law No. 81 August 30, 1991, federal regulations and the PROMB circular G 54-84 which require an effective control and accountability of funds. Property, etc. also the PR controller office established the criteria and clause to be included in the all municipalities contracts.

Cause of condition

The Municipality did not establish the necessary procedures to comply with the bid requirement.

Effect of condition

The Municipality did not comply with the regulations mentioned above and contracts may was granted without all the elements required by law.

Recommendation

The Municipality must establish the necessary policies and procedures to prevent these situation in the future.

Auditee Response

The office of municipal secretary was instructed to prepared check list that include all of the clauses necessities in every contract.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF PRIOR YEARS AUDIT FINDINGS
JUNE 30, 2003**

AUDIT FINDINGS

STATUS

2002.1:

Accounting System

I noted that the Municipality of Maricao is not keeping an accounting system as required by General Accepted Accounting Principles at present time, the Municipality records the transactions in the general capital project and special funds. These funds are kept under the cash basis method. Also, the system used to record the purchased orders and contracts are not adequate because it does not provide for segregation between the account payable and the encumbrances. In order to prepare the combined financial statements, we realized several adjusting entries to convert them to a modified accrual basis of accounting.

Still Prevail

2002.2:

Fixed Assets

During the audit I noted that:

- a. The additions to the property ledger had been recorded on a cash basis, instead of the accrual basis.
- b. There is no supervision process established in order to verify if each department keeps adequate control of the property that is under their responsibility.
- c. Expenditures for financing charges of issued long-term debts, and financing charges related to property, plant and equipment had not been recorded in the property ledger.
- d. There is no supervision process to verify if each department keeps adequate control of inventory.

Corrected

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF PRIOR YEARS AUDIT FINDINGS
JUNE 30, 2003**

AUDIT FINDINGS (Continued)

2002.3:

Accounting Records

During the attempt to audit the Municipality's General Purpose Financial Statements there were several situations hindering the preparation of the General Purpose Financial Statements in accordance with generally accepted accounting principles. These situations were principally due to the following:

Accounting Records

- | | | |
|----|--|---------------------|
| a. | I observed that the accounting records and the information provided by the Municipality contains material errors which I conclude there are transactions realized during the fiscal year 2001-2002 and that were not recorded on the accounting books of the Municipality. | Corrected |
| b. | Significant adjustments had to be made during the audit. | Corrected |
| c. | The Municipality maintains several cash accounts which are either inactive or have limited activity. | Partially Corrected |
| d. | The Municipality did not submit | |
| e. | payment to Internal Revenue | |
| f. | Systems, Retirement System & Department of Labor System. | Corrected |

2002.4:

Bank Accounts and Cash Management

At June 30, 2002, some bank reconciliations showed overdraft and unreconciled items without explanation (previous years).

Partially Corrected

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF MARICAO
SCHEDULE OF PRIOR YEARS AUDIT FINDINGS
JUNE 30, 2003**

AUDIT FINDINGS (Continued)

2002.5:

Municipality outstanding debt with different Governmental entities (Department of Labor Internal Revenues Services and Water and server Authority).

Partially Corrected

2002.6:

Purchasing and Receiving

My review of thirty five (35) disbursement vouchers for municipality general fund revealed noncompliance with applicable internal control requirements. My review of the supporting documentation revealed the following documents were missing or incomplete:

Partially Corrected

| Description | Municipality Funds |
|--|-------------------------------|
| a. Receiving materials and Service before purchase order | 12 |
| b. Quotation not found | 9 |
| c. Receiving and inspection sheets not prepared | 10 |
| d. Invoice without certification | 9 |

2002.7:

Revenues/Accounts Receivable

The following deficiency was found in the revenue and accounts receivable area:

- a. 9 of 24 taxpayer files did not have evidence of income tax return

Still Prevail

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AUDIT FINDINGS (Continued)

2002.8:

Personnel Files

My review of fifteen (15) personnel files for the year under audit revealed the following instances where the required documents were not found:

Still Prevail

| <u>Document</u> | <u>Exceptions</u> |
|--|-------------------|
| Governmental Ethics Laws were discussed with the employees | 15 |

In addition, the following deficiencies were found:

There shall be an adequate retribution plan to identify the classification of the vacancies in the Municipality.

Still Prevail

2002.9:

Bids

As part of my examination of the bids procedures of the Municipality, I requested the file and documents for the eleven (11) bids granted during the year. The following summarizes the deficiencies found:

- a. 3 of 11 the contract did not provide the income tax retention for professional services, according to income tax law.
- b. 2 of 11 the contract did not have the clause that will pay alimony.
- c. 4 of 11 the contract did not provide for the budget account from which the service will be pay.
- d. 2 of 11 the contract did not provide that the employees did not have direct or indirect interest with the municipality.
- e. 5 of 11 the contract did not include the clause that mentioned the circular letter.
- f. 5 of 11 the contract did not have the clause that the person did not receive payment of other entity.

Still Prevail

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AUDIT FINDINGS (Continued)

2002.10:

“Liquidacion Presupuestaria”

The Liquidacion Presupuestaria was not properly prepared. During the performance of my procedures, the following exception was noted:

Corrected

The “Liquidacion Presupuestaria” must be submitted to the office of the Commissioner of Municipal Affairs (OCAM) no later than September 30 of each year. As of the date of this report, the municipality has not complied with this requirement.