

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

**MUNICIPIO DE MAYAGUEZ**  
**AUDITORIA 2002-2003**  
**30 DE JUNIO DE 2003**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**BASIC FINANCIAL STATEMENTS  
With Independent Auditors' Report Thereon  
June 30, 2003**

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**Basic Financial Statements**  
**June 30, 2003**

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SINGLE AUDIT REPORT  
JUNE 30, 2003**

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## **NIEVES VELAZQUEZ & CO., P.S.C.**

**Certified Public Accountants and Financial Consultants**

### **Independent Auditors' Report**

The Honorable Mayor, Members of the  
Municipal Legislature and People of  
the Municipality of Mayagüez  
Mayagüez, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **the Municipality of Mayagüez** 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 table of contents. We also have audited the accompanying statement of revenues and expenditures – budget and actual – budgetary basis – general and debt service funds of **the Municipality** for the year then ended, which is presented as part of the basic financial statements. These financial statements are the responsibility of **the Municipality's** management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of **the Municipality**, 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 addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the budgetary comparison of the general and debt service funds for the year then ended in conformity with the budgetary (statutory) basis of accounting, as described in Note 1.

**Independent Auditors' Report**  
(Continuation)

As described in Note 1, on July 1, 2002 **the Municipality** implemented a new financial reporting model required by GASB Statement No. 34 (GASB No. 34), *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments*. In conjunction with the adoption of GASB No. 34, **the Municipality** has also adopted the following pronouncements: (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*.

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

January 15, 2004  
San Juan, Puerto Rico

*Nieves Velazquez & Co., P.S.C.*

Stamp No. 1882074 of the Puerto Rico Society of Certified Public Accountants was affixed to the record copy of this report.



COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ  
Management's Discussion and Analysis  
Year ended June 30, 2003

Management of **the Municipality of Mayagüez** of the Commonwealth of Puerto Rico (**the Municipality**) provides this *Management's Discussion and Analysis* (MD&A) for the readers of **the Municipality's** basic financial statements. This narrative represents an overview and analysis of the financial activities of **the Municipality** for the fiscal year ended June 30, 2003. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information 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 (GASB No. 34). According to this statement, significant required changes in content and structure have been made in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2003, which make them not easily comparable with prior years' financial statements. However, in future years, comparative analysis will be more meaningful and will go further in explaining **the Municipality's** financial position and results of operations.

## FINANCIAL HIGHLIGHTS

### a) Government-Wide Highlights

- **Assets** – **The Municipality** has reported assets amounting to \$119,502,851 in the accompanying statement of net assets, of which the most significant are capital assets, cash, short-term investments and tax receivables amounting to \$38,316,886, \$41,960,633, \$19,000,000, and \$12,224,560, respectively. These assets account for \$111,502,079 or 93% of **the Municipality's** total assets.
- **Liabilities** – **The Municipality** has reported liabilities amounting to \$99,395,588 in the accompanying statement of net assets, of which the most significant are bonds and notes payable, deferred revenues, compensated absences, and accounts payable amounting to \$54,121,231, \$21,776,865, \$7,949,666 and \$8,617,408, respectively. These liabilities account for \$92,465,170 or 93% of **the Municipality's** total liabilities.
- **Net assets** – The assets of **the Municipality** exceeded its liabilities by \$20,107,263 at June 30, 2003, which is presented as "net assets" in the accompanying statement of net assets. Restricted net assets and unrestricted net assets amounted to \$14,737,508 and \$4,503,758, respectively. Net assets invested in capital assets amounted to \$865,997.

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- *Net change in net assets* – **The Municipality's** net assets increased by \$8,801,754 (78% increase) during fiscal year ended June 30, 2003. Net assets at June 30, 2002 amounted to \$11,305,509. The increase in net assets represents a positive result of operations and an improvement in **the Municipality's** overall financial position in comparison with the prior fiscal year.
- *Revenues* – **The Municipality** has reported total revenues amounting to \$85,538,796 in the accompanying statement of activities, of which the most significant are tax revenues, intergovernmental grants and contributions and charges for services amounting to \$45,082,025, \$32,550,519 and \$3,949,772, respectively. These revenues account for \$81,582,316 or 95% of **the Municipality's** total revenues.
- *Expenses* – **The Municipality** has reported total expenses amounting to \$76,737,042 in the accompanying statement of activities, of which the most significant are categorized as general government; culture, recreation and education; health and sanitation; and urban and economic development amounting to \$30,731,919, \$13,850,365, \$9,822,824 and \$8,717,198, respectively. These expenses accounted for \$63,122,306 or 82% of **the Municipality's** total expenses.

**b) Governmental Funds Highlights**

- *Assets* – **The Municipality's** governmental funds have reported combined assets amounting to \$84,619,299 in the accompanying balance sheet – governmental funds, of which the most significant are cash, short-term investments and taxes receivable amounting to \$41,960,633, \$19,000,000 and \$12,224,560, respectively. These assets account for \$73,185,193 or 86% of **the Municipality's** combined governmental funds assets.
- *Liabilities* – **The Municipality's** governmental funds have reported combined liabilities amounting to \$50,808,010 in the accompanying balance sheet – governmental funds, of which the most significant are deferred revenues, accounts payable and matured principal and interest of bonds and notes amounting to \$36,455,876, \$5,341,064 and \$4,669,850, respectively. These liabilities account for \$46,466,790 or 91% of **the Municipality's** combined governmental fund liabilities.
- *Governmental fund balances* – **The Municipality's** governmental funds reported combined fund balances amounting to \$33,811,289, of which \$25,718,603 and \$8,092,686 represent reserved and unreserved fund balances, respectively.
- *Net change in governmental fund balances* – **The Municipality's** governmental fund balances decreased by \$1,472,419 (4% decrease) during fiscal year ended June 30, 2003. Governmental fund balances at June 30, 2002, as restated, amounted to

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\$35,283,708. The increase in net assets represents the excess of expenditures and other financing uses over revenues and other financing sources.

- *Revenues* – **The Municipality's** governmental funds have reported combined revenues amounting to \$79,707,015 in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are tax revenues, intergovernmental grants and contributions, and charges for services amounting to \$43,012,897, \$31,912,475 and \$2,664,733, respectively. These revenues account for \$77,590,105 or 97% of **the Municipality's** combined governmental fund revenues.
- *Expenditures* – **The Municipality's** governmental funds have reported combined expenditures amounting to \$81,484,374 in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as general government; culture, recreation and education; health and sanitation; public housing and welfare; urban and economic development; debt service; and capital outlays amounting to \$27,726,335, \$13,660,004, \$8,665,766 and \$7,686,025, \$7,672,147, \$7,601,915, and \$5,423,490 respectively. These expenses accounted for \$78,435,682 or 96% of **the Municipality's** total expenses.

## OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This management's discussion and analysis is intended to serve as an introduction to the accompanying basic financial statements. **The Municipality's** basic financial statements include three components: (1) government-wide financial statements, (2) governmental fund financial statements, and (3) notes to the basic financial statements. This report also contains additional required and non required supplementary information in addition to the basic financial statements themselves. These components are described below.

The new basic financial statements are the result of a significant change in the focus of financial reporting in comparison with the financial statements previously issued by **the Municipality**. The new basic financial statements focus on: (1) **the Municipality** as a whole (government-wide financial reporting) and, (2) **the Municipality's** major individual governmental funds discussed below. Both perspectives (government-wide and major governmental fund financial reporting) 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. The components of the basic financial statements are described below.

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**a) 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 June 30, 2003. 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 private 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 are composed of: (1) the statements of net assets and (2) the statement of activities.

**1. 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.

**2. 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 abovementioned financial statements present all of **the Municipality's** governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions). All services normally associated with **the Municipality** fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; public housing and welfare; and economic and urban development. The government-wide financial statements can be found immediately following this management's discussion and analysis.

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**b) Governmental Fund Financial Statements**

The **Municipality's** governmental fund financial statements 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, with an emphasis on **the Municipality's** major 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 governmental 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 governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, (4) capital projects funds and (5) permanent funds.

Governmental funds are used to account for all of the services provided by **the Municipality**. These funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable financial resources. They also focus on the balances of expendable financial resources available at the end of the fiscal year (June 30, 2003). This approach is known as the flow of current financial resources measurement focus, which uses the modified accrual basis of accounting. These statements provide a detailed short-term view of **the Municipality's** finances that assist 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. Both the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and the governmental activities reported in the government-wide financial statements.

As previously mentioned, **the Municipality** has four major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The four major governmental funds are: (1) the general fund, (2) the debt

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service fund, (3) the state legislative joint resolutions special revenue fund, and (4) the head start special revenue fund.

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.

**The Municipality** has no activities that operate more like those of commercial enterprises nor have resources held for the benefit of parties outside **the Municipality's** government. Consequently, **the Municipality** has not reported proprietary funds nor fiduciary funds in the accompanying basic financial statements. The governmental funds financial statements can be found immediately following the government-wide financial statements.

**c) Notes to Basic Financial Statements**

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

**d) Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information (RSI) which consists of a schedule of funding progress of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS). ERS is the retirement system in which the employees of **the Municipality** participate.

**e) Other Supplementary Information**

The RSI is followed by a section of other supplementary information consisting of: (1) combining balance sheet – non major governmental funds, (2) combining statement of revenues, expenditures and changes in fund balances (deficits) – non major governmental funds, (3) schedule of revenues and expenditures – budget and actual – budgetary basis – debt service fund, and (4) schedules of capital assets used in the operation of governmental funds, as detailed in the accompanying table of contents.

**INFRASTRUCTURE ASSETS**

Historically, infrastructure assets, which are one of **the Municipality's** largest group of assets (consisting of roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements.

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According to GASB No. 34, **the Municipality** has valued and reported infrastructure assets in the accompanying government-wide financial statements. Additionally, under the provisions of GASB No. 34, **the Municipality** had the option 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 Municipality** had developed the asset management system (commonly known as the *modified approach*), then **the Municipality** would have measured and demonstrated its maintenance of locally established levels of service standards at least every three years for each infrastructure asset category. Under the modified approach, **the Municipality** would have recorded its cost of maintenance in lieu of depreciation and amortization. As of July 1, 2002, **the Municipality** retroactively recorded the estimated historical costs of infrastructure assets in the accompanying government-wide financial statements. Also **the Municipality** elected to depreciate infrastructure assets instead of using the modified approach.

#### GOVERNMENT-WIDE FINANCIAL ANALYSIS

##### a) Net Assets

As noted earlier, net assets may serve over time as a useful indicator of **the Municipality's** financial position. Total assets and total liabilities at June 30, 2003 amounted to \$119,502,851 and \$99,395,588, respectively, for net assets of \$20,107,263, compared to net assets of \$11,305,509 at June 30, 2002.

A portion of **the Municipality's** net assets, amounting to \$865,997, reflects its investment in capital assets (such as land, buildings, equipment, etc.) less any related debt used to acquire those assets that are still outstanding. **The Municipality** uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although **the Municipality's** investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of **the Municipality's** net assets amounting to \$14,737,508 represents resources that are subject to external restrictions on how they may be used. Restrictions on these resources are mainly related to: (1) the financing of federally and state assisted programs, (2) the future payment of debt service and (3) other specific purposes.

A final portion of **the Municipality's** net assets amounting to \$4,503,758 represents available resources to be used to meet **the Municipality's** ongoing obligations to citizens and creditors. Internally imposed designations of resources are not presented as restricted net assets. These unrestricted net assets are the consequence of previous

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budgets that provided sufficient funding for incurred long-term obligations, such as capital lease obligations, compensated absences, claims and judgments, federal cost disallowances, etc. Historically, such obligations have been budgeted on a pay as you go basis providing funding for their future liquidation. Consequently, **the Municipality** can draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

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

**Condensed Statement of Net Assets**  
**June 30, 2003**

	<b>Governmental activities</b>
<i>Assets:</i>	
Current assets	\$ 80,691,450
Noncurrent assets:	
Capital assets, net	38,316,886
Other noncurrent assets	494,515
Total assets	\$ 119,502,851
 <i>Liabilities:</i>	
Current liabilities	\$ 34,381,805
Long-term liabilities due within one year	9,019,967
Long-term liabilities due after one year	55,993,816
Total liabilities	\$ 99,395,588
 <i>Net assets (liabilities):</i>	
Invested in capital assets, net of related debt	\$ 865,977
Restricted	14,737,508
Unrestricted	4,503,758
Total net assets	\$ 20,107,263

**The Municipality's** current assets amounting to \$80,691,450 are mainly composed of cash, short-term investments in certificates of deposit and property tax receivable amounting to \$41,960,633, \$19,000,000 and \$9,924,093, respectively. The total cash includes restricted cash amounting to \$39,285,205, which represents resources legally designated for the payment of debt service, the acquisition, construction and improvement of major capital assets, and resources designated for the operations of federally and state funded programs. Restricted cash also consists of unspent proceeds of bonds issued to pay accounts payable and certain specific commitments, previously

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agreed with and approved by the Government Development Bank for Puerto Rico. The short-term investments in certificates of deposit are unrestricted and available to meet operational needs and obligations with citizens and creditors.

**The Municipality's** non current assets amounting to \$38,811,401 are substantially composed of capital assets, net of accumulated depreciation and amortization, amounting to \$38,316,886.

**The Municipality's** current liabilities amounting to \$43,401,772 are mainly composed of deferred revenues, accounts payable, and the current portions of compensated absences and bonds payable amounting to \$21,776,865, \$8,617,408, \$3,847,328 and \$3,353,000, respectively. Deferred revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded programs.

**The Municipality's** non current liabilities amounting to \$55,993,816 are mainly composed of the long-term portions of bonds and notes payable, and compensated absences amounting to \$49,937,849 and \$4,102,338, respectively.

As noted in the condensed statement of net assets, **the Municipality's** current assets exceeded current liabilities by \$37,289,678, for a current ratio (current assets to current liabilities) of 1.89 to 1.00.

Total bonds and notes payable at June 30, 2003 decreased by \$4,191,050, in comparison with their respective balances at June 30, 2002, due principally to the debt service payments made during the current fiscal year. Compensated absences decreased by \$783,574 due to the strategy followed by management to encourage employees to use a significant portion of their accumulated time for vacations, sick leave, and compensatory time before June 30, 2003.

**b) Changes in Net Assets**

**The Municipality's** net assets increased by \$8,801,754 or 78% from last year's total net assets. Approximately 53% of **the Municipality's** total revenues (\$45,082,025) came from property, municipal license and construction excise taxes, while 38% (\$32,550,519) resulted from restricted and unrestricted capital and operating grants and contributions. Charges for services provided 4% (\$3,949,772) of the total revenues.

**The Municipality's** expenses cover a wide range of services. The largest expenses of **the Municipality** were related to: (1) general administrating and operating costs (\$30,731,919), which were classified as "general government" and accounted for 40% of total expenses, (2) culture, recreation and education (\$13,850,365), which accounted for 18% of total expenses, (3) health and sanitation (\$9,822,824), which accounted for 13% of total expenses, (4) urban and economic development (\$8,717,198), which accounted

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for 11% of total expenses and (5) public housing and welfare (\$7,167,815), which accounted for 9% of total expenses.

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

**Condensed Statement of Activities**  
**Year Ended June 30, 2003**

***Program revenues:***

Program-specific operating grants and contributions	\$ 16,686,790
Program-specific capital grants and contributions	3,699,105
Charges for services	<u>3,949,772</u>
Total program revenues	<u>24,335,667</u>

***General revenues and special item:***

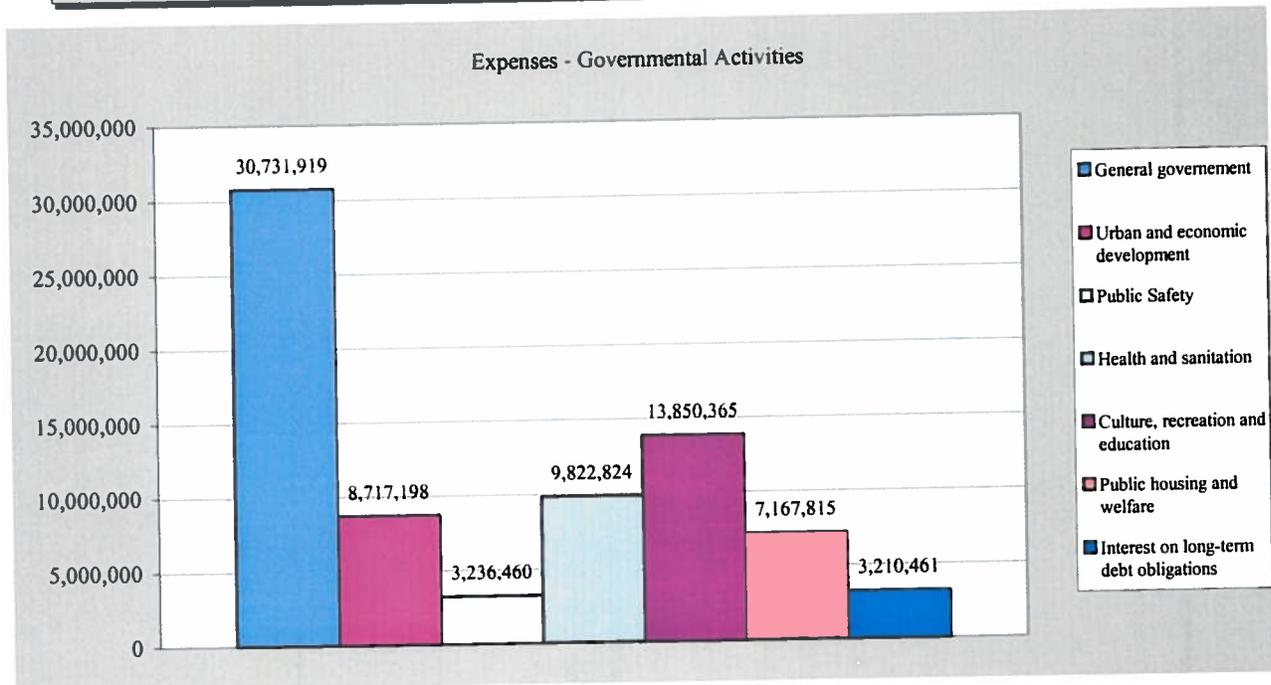
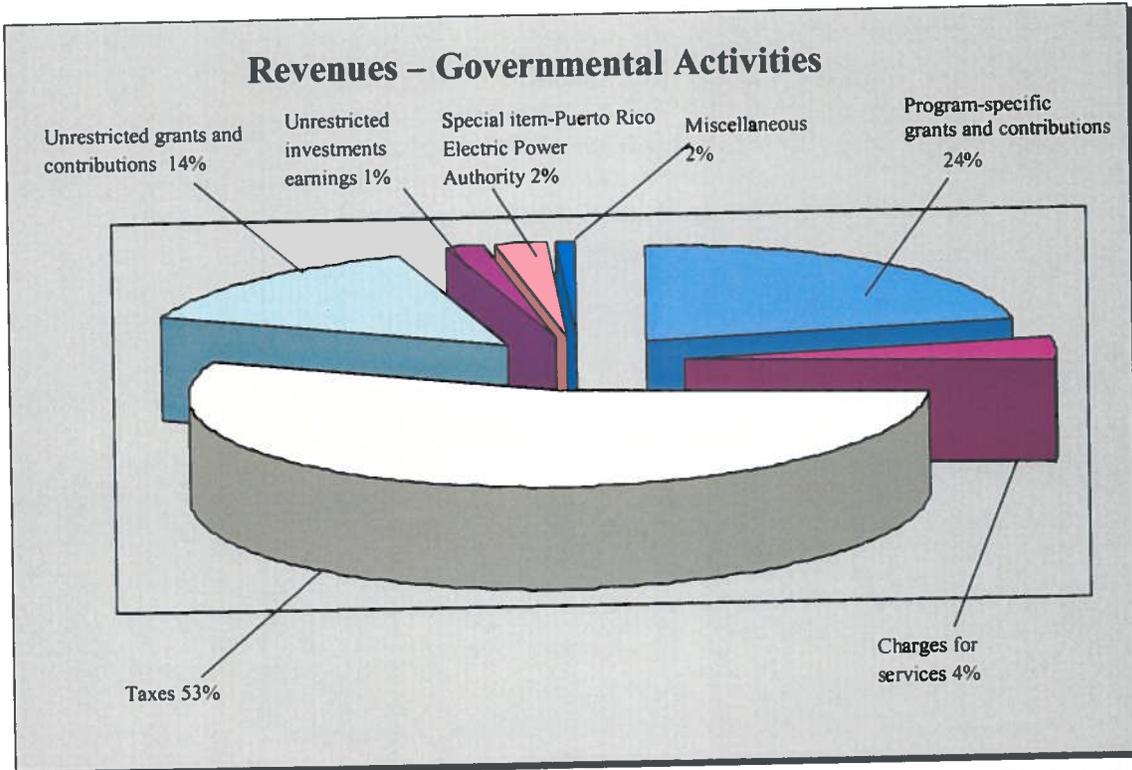
Property taxes	24,818,421
Municipal license taxes	17,875,387
Unrestricted intergovernmental grants and contributions	12,164,624
Other general revenues (various sources)	4,505,127
Special item – Puerto Rico Electric Power Authority	<u>1,839,570</u>
Total general revenues	<u>61,203,129</u>
Total revenues	<u>85,538,796</u>

***Program expenses:***

General government	30,731,919
Urban and economic development	8,717,198
Public safety	3,236,460
Health and sanitation	9,822,824
Culture, recreation and education	13,850,365
Public housing and welfare	7,167,815
Interest on long-term obligations	<u>3,210,461</u>
Total expenses	<u>76,737,042</u>

<i>Net increase in net assets</i>	8,801,754
<i>Net assets – at beginning of year</i>	<u>11,305,509</u>
<i>Net assets – at end of year</i>	<u>\$ 20,107,263</u>

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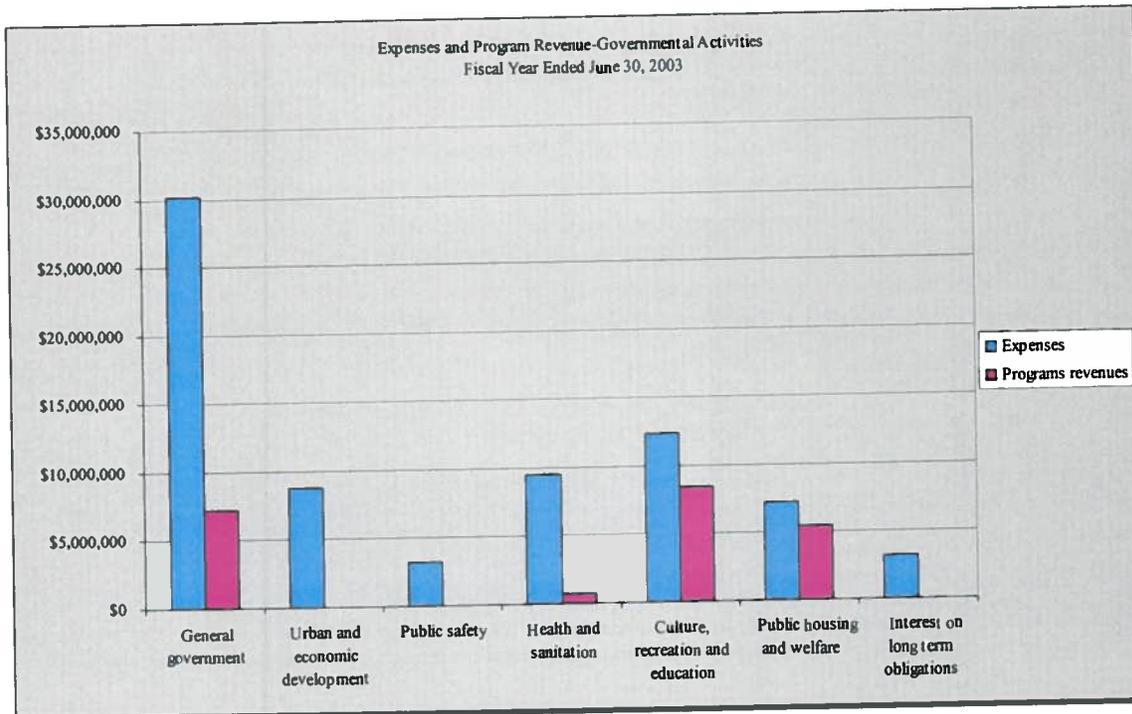
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Governmental activities increased the Municipality's net assets by \$8,801,754. A comparison of the cost of services by function for the Municipality's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities.

**Governmental Activities - Expenses Net of Program Revenues:**  
**Year Ended June 30, 2003**

<i>Net expenses:</i>	
General government	\$ (22,547,993)
Urban and economic development	(8,717,198)
Public safety	(3,236,460)
Health and sanitation	(9,085,345)
Culture, recreation and education	(3,926,173)
Public housing and welfare	(1,677,745)
Interest on long-term obligations	<u>(3,210,461)</u>
Total governmental activities' net expenses	<u>(52,401,375)</u>
 <i>General revenues:</i>	
Taxes	45,082,025
Unrestricted intergovernmental grants and contributions	12,164,624
Other revenues sources	<u>3,956,480</u>
Total governmental activities general revenues	<u>61,203,129</u>
Net increase in net assets	<u><u>\$ 8,801,754</u></u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**Management's Discussion and Analysis**  
**Year ended June 30, 2003**



**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

As discussed earlier, **the Municipality** uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of **the Municipality's** governmental funds is to provide information on near-term inflows, outflows, and balances 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 the fiscal year.

At June 30, 2003, **the Municipality's** governmental funds reported combined fund balances of \$33,811,289, a decrease of \$1,472,419 or 4% in comparison with the prior year. There are \$25,718,603 of reserved fund balances, which are not available for new spending because have been already committed to: (1) liquidate contracts and purchase orders of the prior fiscal year (\$1,643,357), (2) pay debt service (\$9,547,388), (3) finance capital projects (\$6,756,886) and (4) for advances, long-term receivables, the operations of state and federally funded programs and other restricted purposes (\$7,770,972).

The general fund is the main operating fund of **the Municipality**. At the end of the current fiscal year, unreserved fund balance of the general fund was \$8,463,426, while its total fund balance reached \$12,311,720. The fund balance of the general fund increased by \$4,183,871 due to the excess of revenues and other financing sources over

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expenditures and other financing uses. This is a 51% increase in the general fund's fund balance in comparison with the prior year.

The general fund accounts for 47% and 54% of the total assets and total liabilities, respectively, of governmental funds at June 30, 2003. In the other hand, the debt service fund accounts for 19% and 13% of the total assets and total liabilities, respectively, of such funds at the end of the fiscal year.

The state legislative joint resolutions special revenue fund and the head start special revenue fund account for 10% and 1% of **the Municipality's** total governmental fund assets, respectively, at the end of the current fiscal year. These two major governmental funds account also for 16% and 1% of **the Municipality's** total governmental fund liabilities, respectively, at June 30, 2003.

Combined revenues of governmental funds for the year ended June 30, 2003 amounted to \$79,707,015, while total combined revenues for the prior year amounted to \$76,914,955. This represents an increase of \$2,792,060 or 4% in comparison with the prior year.

The general fund accounts for 68% and 63% of the total revenues and total expenditures, respectively, of governmental funds for the year ended June 30, 2003. In the other hand, the debt service fund accounts for 6% and 8% of the total revenues and total expenditures, respectively, of governmental funds for the current fiscal year.

The state legislative joint resolutions special revenue fund and the head start special revenue fund account for 1% and 12% of **the Municipality's** total governmental fund revenues, respectively, for the current fiscal year. These two major governmental funds account also for 1% and 13%, respectively, of **the Municipality's** total governmental fund expenditures for the year ended June 30, 2003.

The following is a condensed presentation of **the Municipality's** balance sheet and results of operations of governmental funds:

**Condensed Balance Sheet – Governmental Funds**  
**June 30, 2003**

**Assets:**

Total assets – major governmental funds	\$ 65,114,203
Total assets – other governmental funds	<u>19,505,096</u>
Combined total assets	<u>84,619,299</u>

**Liabilities:**

Total liabilities – major governmental funds	43,251,781
Total liabilities – other governmental funds	<u>7,556,229</u>

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Combined total liabilities	50,808,010
<b><i>Fund Balances:</i></b>	
Reserved – major governmental funds	13,769,736
Reserved – other governmental funds	11,948,867
Unreserved – major governmental funds	8,092,686
Combined total fund balances	\$ 33,811,289

**Condensed Statement of Revenues, Expenditures  
and Changes in Fund Balances – Governmental Funds**  
Year Ended June 30, 2003

<b><i>Revenues:</i></b>	
Total revenues – major governmental funds	\$ 69,191,709
Total revenues – other governmental funds	10,515,306
Combined total revenues	79,707,015
<b><i>Expenditures:</i></b>	
Total expenditures – major governmental funds	68,410,800
Total expenditures – other governmental funds	13,073,574
Combined total expenditures	81,484,374
<b><i>Other financing sources (uses), net:</i></b>	
Major governmental funds	1,410,874
Other governmental funds	(1,105,934)
Combined total other financing sources (uses), net	304,940
<b><i>Excess of expenditures and other financing uses over revenues and other financing sources</i></b>	(1,472,419)
<b><i>Fund balance at beginning of year, as restated</i></b>	35,283,708
<b><i>Fund balance at end of year</i></b>	\$ 33,811,289

**BUDGETARY HIGHLIGHTS**

**a) General Fund**

The original budget and the final amended budget of the general fund remained substantially the same except for reclassification of expenditures made throughout the year. Over the course of the year, **the Municipality** revised the general fund'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**

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**Municipality's** finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2003 were \$47,488,513, which is \$1,929,329 (4%) less than the budgeted revenues.

Actual municipal license revenues were \$2,673,033 more than budgeted municipal license revenues. Such variance is due to the collection of \$1,345,000 received from a major taxpayer in relation to a tax deficiency imposed.

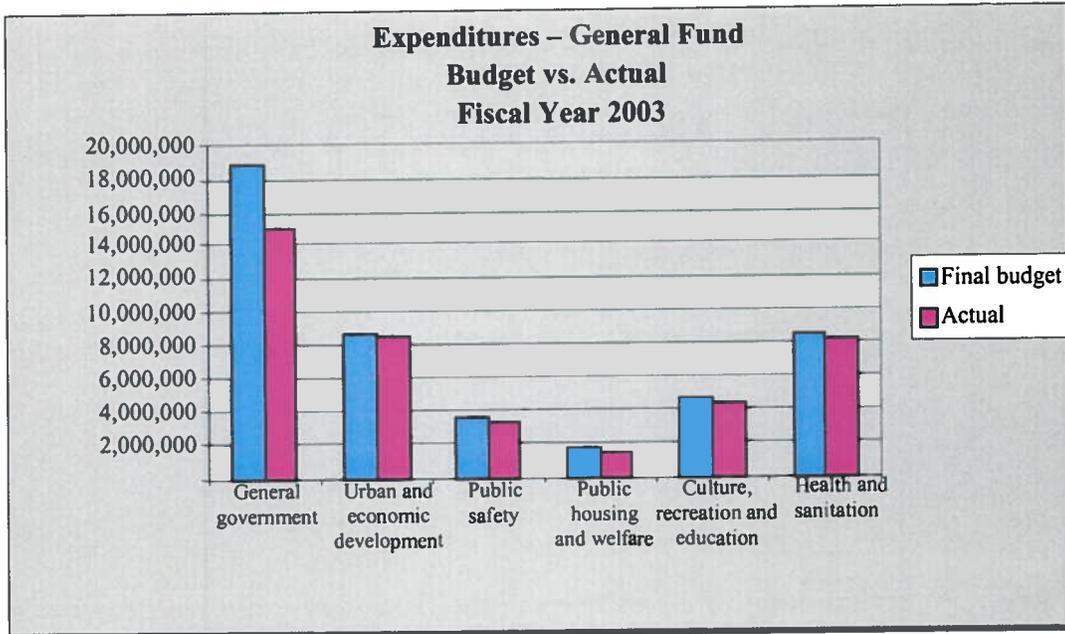
Actual investment earnings were \$1,364,224 less than budgeted investment earnings. Such variance is due to the decrease in market interest rates, which reduced **the Municipality's** return on its investments in certificates of deposit and interest bearing accounts.

Actual miscellaneous revenues were \$2,329,040 less than budgeted miscellaneous revenues. Such variance is due to a budgetary readjustment made by management to include as part of the current year budgeted revenues, the financial resources arising from cash surpluses of fiscal year 2001-2002. These amounts were reported as budgeted revenues of fiscal year 2002-2003, as permitted by law, but do not constitute actual revenues under the budgetary basis of accounting.

The total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2003 were \$42,594,095, which is \$5,372,799 (11%) less than the budgeted expenditures. Such variance is due to a cost reduction plan and certain budget control strategies implemented by **the Municipality** during the current year, principally on general and administrative costs for which actual amounts were \$3,844,401 under budgeted amounts for the current year. Non-budgeted other financing sources, net, amounted to \$3,069,282, which consist principally of: (1) interest transferred to the general fund from the debt service fund, as permitted by law and (2) cash surplus transfers from other governmental funds to the general fund (see note 8).

The following table highlights the actual expenditures (budgetary basis) for **the Municipality's** functions/programs, in comparison with budgeted amounts for the general fund:

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**b) Debt Service Fund**

The total actual revenues (budgetary basis) of the debt service fund for the fiscal year ended June 30, 2003 were \$4,682,427, which is \$1,010,862 (18%) less than the budgeted revenues.

Actual property tax revenues were \$1,134,942 less than budgeted property taxes. Such variance is due to a decrease in the advances of property taxes remitted by the Municipal Revenue Collection Center (CRIM, by its Spanish acronym) to **the Municipality** during fiscal year 2002-2003, which is caused by a reduction in the actual collection experience of CRIM and the fluctuation in the net assessed valuation of real and personal property of **the Municipality of Mayagüez**.

The non-budgeted transfers-in from other funds amounting to \$1,093,401, represent amounts received from the general fund to partially cover debt service requirements. The non-budgeted transfers-out to other funds amounting to \$1,625,727, represent mainly the transfer of \$1,500,000 to the Eugenio María de Hostos law school special revenue fund, as a donation for the acquisition of books and library materials.

The total actual expenditures (budgetary basis) of the debt service fund for the same year previously mentioned were \$6,506,626, which is \$813,337 (14%) more than the budgeted expenditures. The fluctuation in actual expenditures is due to the increase in interest rates, which are reviewed periodically by the Government Development Bank for Puerto Rico. Non-budgeted other financing sources, net, amounted to \$532,326.

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

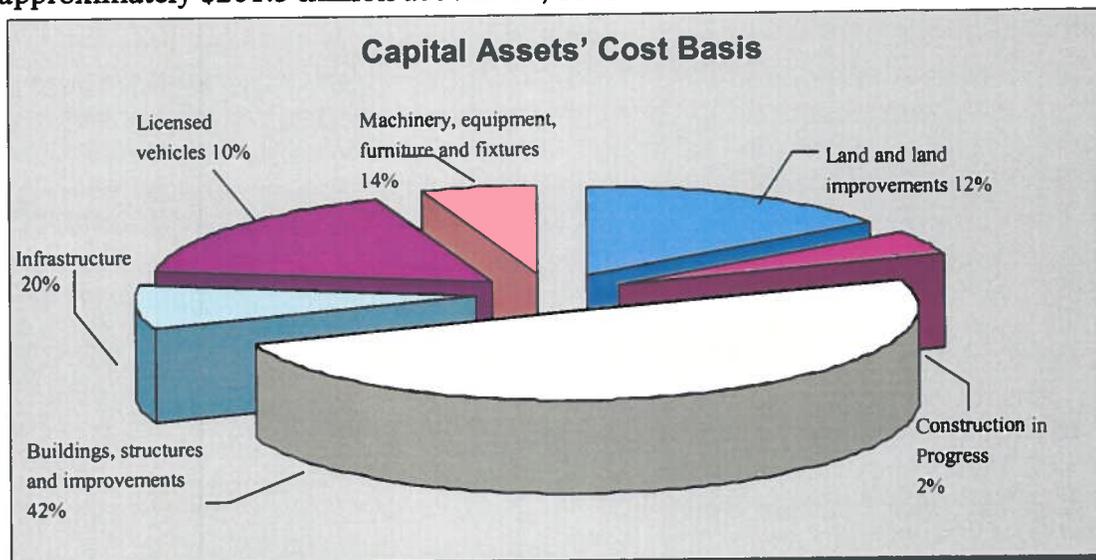
**a) Capital Assets**

The accompanying statement of net assets reported capital assets, at cost, amounting to \$90,032,764, of which \$17,749,825 represent infrastructure assets at June 30, 2003. The related accumulated depreciation and amortization of capital assets amounted to \$51,715,878 of which \$14,123,865 is related to infrastructure assets at June 30, 2003. The investment in capital assets includes land and land improvements, buildings and buildings improvements, machinery and equipment, licensed vehicles, furniture and fixtures, infrastructure and construction in progress.

The net book value of capital assets at June 30, 2003 is distributed by function/activity. Actual expenditures to purchase or construct capital assets were \$5,423,490 for the year. A significant portion of this amount was incurred in approximately 35 construction projects, which were substantially completed at June 30, 2003 (\$2,794,622 or 51%), and the acquisition of land parcels (\$1,566,378 or 29%). Depreciation and amortization charges for the year totaled \$4,017,990.

The increase in net capital assets at June 30, 2003 in comparison with the respective figures at June 30, 2002 was \$1,405,500. Such increase is due to the net effect of the additions to capital assets amounting to \$5,423,490 made during the year, and the effect of depreciation and amortization expense of \$4,017,990.

The estimated aggregate replacement cost of these capital assets amounted to approximately \$201.5 million at June 30, 2003.



**b) Debt Administration**

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**b) Debt Administration**

**The Municipality** finances a significant portion of its construction activities through bond and notes issuances and through 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.

Based on the current total net assessed valuation of real and personal property of Mayagüez provided by the Municipal Revenues Collection Center of \$528,718,491, the total legal margin of **the Municipality** as of June 30, 2003 was \$52,871,849, which is 10% of the total assessed valuation. **The Municipality's** available legal margin at June 30, 2003 was calculated by the Government Development Bank for Puerto Rico (GDB) to equal \$9,667,261 after subtracting from the legal margin the outstanding general obligation debt, and adding to the legal margin the excess amount in its redemption fund.

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 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 and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by **the Municipality** constitute a first lien on **the Municipality's** basic tax revenues. Accordingly, **the Municipality's** basic tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the special additional tax levied by **the Municipality**, together with moneys on deposit in **the Municipality's** redemption fund, are not sufficient to cover such debt service. It has never been necessary to apply basic taxes to pay debt service on general obligation debt of **the Municipality**.

Total long-term obligations at June 30, 2003 decreased \$4,733,004 in comparison with the respective amounts at June 30, 2002. The decrease is due to the net effect of

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payments made during the year amounting to \$5,563,858, borrowings and other increases in long-term obligations of \$741,049 and the amortization of discount of notes payable in the amount of \$89,805.

For more detailed information related to the capital assets and long-term debt activity for the year ended June 30, 2003, please refer to the accompanying notes to the basic financial statements.

### ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The territory of Mayagüez covers an area of approximately 77 square miles. Mayagüez is **the Municipality** with the highest population density in the western region (the Region), with a population density of 1,267.9 habitants per square mile, which is equivalent to 19.53% of the total population of the Region.

Mayagüez is characterized by being the economic integration center of the Region since it is considered the principal source of jobs and services of commercial, educational and health nature in the Region. From the industrial perspective, Mayagüez accounts for 16.65% of the manufacturing jobs, 25.30% of the finance-related jobs and 21.13% of the service-related jobs in the Region.

The unemployment rate for Mayagüez is currently 23.0%, which is substantially higher than the overall unemployment rate of Puerto Rico, which is approximately 19.2% at June 30, 2003. However, the overall unemployment rate for all the municipalities in the Region is 23.7%, which is higher than the rate of **the Municipality**.

Of the total population of **the Municipality**, 50.5% or 50,805 persons are considered to live under the poverty level. This rate is lower than the overall rate for the region (53.9%) but higher than the overall rate for Puerto Rico (48.2%). Approximately 19.9% of the population of Mayagüez receives public financial assistance as their principal source of income.

The municipalities of Añasco, Cabo Rojo, Hormigueros, San Germán, Sabana Grande and Mayagüez constitute the employment market area (EMA) of Mayagüez, as defined by the Department of Labor and Human Resources of Puerto Rico. Of the total 77,707 jobs in this Region, Mayagüez participates in 63.08% of them, for a total of 29,811 jobs. This figure is lower than the corresponding EMA of the Ponce region (55.0%), but higher than the EMA of the San Juan region (23.7%). However, 81.7% of the workers of Mayagüez are residents of Mayagüez, while the corresponding percentage for Ponce and San Juan are 86.4% and 75.1%, respectively.

Based on the projections of the Planning Board of the Commonwealth of Puerto Rico, the economy of Puerto Rico, including Mayagüez, reflected a real growth of 2.7% for

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the fiscal year ended June 30, 2003. In nominal terms, the economy increased 6.8% during fiscal year 2002-2003.

**The Municipality** relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out its governmental activities. Historically, property and municipal license taxes have been very predictable with increases or decreases 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 budgets for fiscal year 2002-2003 and the budgets for fiscal year 2003-2004. The budgets of the general fund and the debt service fund for fiscal year 2003-2004 amounted to \$51,654,803 and \$6,048,332, respectively. These budgeted figures are \$2,236,961 (4.5%) and \$355,043 (6.2%), respectively, higher than the prior year's respective budgets of both funds.

The general fund's 2003-2004 budget has been assigned to: (1) salaries, wages and professional services (\$25,372,950 or 49%), (2) materials, services and other operating expenses (\$24,628,916 or 48%), (3) debt service (\$1,526,751 or 3%) and capital assets (\$126,186 or 0.2%)

#### **REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of **the Municipality's** finances for all of **the Municipality's** citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate **the Municipality's** accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Mayagüez, Department of Finance and Budget, P. O. Box 945, Mayagüez, Puerto Rico, 00681.

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

<b>Assets</b>	<b>Governmental activities</b>
<b>Current assets:</b>	
Cash in commercial banks	\$ 2,675,608
Accounts receivable, net of allowance for doubtful accounts:	
Taxes:	
Property taxes:	7,529,622
Municipal license taxes	2,300,467
Current portion of mortgage loans and notes	592,543
Accrued interest	63,237
Intergovernmental	4,594,528
Other	2,101,608
Inventories and other current assets	154,341
Investments	19,000,000
<b>Restricted assets:</b>	
Cash in commercial banks	16,386,939
Cash in fiscal agent	22,898,086
Property taxes, net of allowance for doubtful accounts	2,394,471
Total current assets	80,691,450
<b>Noncurrent assets:</b>	
Mortgage loans and notes, excluding current portion	286,167
Capital assets, net of accumulated depreciation and amortization of \$51,715,878	38,316,886
Deferred charges, net of accumulated amortization of \$142,742	208,348
Total noncurrent assets	38,811,401
Total assets	\$ 119,502,851

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Statement of Net Assets (continued)  
June 30, 2003

**Liabilities and net assets**

	<u>Governmental activities</u>
<b>Current liabilities (due within one year):</b>	
Accounts payable	\$ 8,617,408
Accrued liabilities, including accrued interest of \$1,370,668	2,075,237
Intergovernmental payables	1,912,295
Deferred revenues	21,776,865
Current portion of long-term obligations:	
Bonds payable	3,353,000
Notes payable	830,382
Obligation under capital leases	488,471
Compensated absences	3,847,328
Claims and judgments	500,786
Total current liabilities	<u>43,401,772</u>
 <b>Noncurrent liabilities (due in more than one year) :</b>	
Bonds payable	43,464,000
Notes payable, including bond anticipation notes of \$5,388,395	6,473,849
Obligation under capital leases	538,204
Compensated absences	4,102,338
Estimated liability for municipal solid waste landfill closure and postclosure care costs	<u>1,415,425</u>
Total noncurrent liabilities	<u>55,993,816</u>
Total liabilities	<u>99,395,588</u>
 <b>Net assets:</b>	
Invested in capital assets, net of related debt	<u>865,997</u>
Restricted for:	
Debt service	\$ 9,542,212
Mortgage loans and notes:	
Nonexpendable	917,612
Expendable	8,417
Other specified purposes	<u>4,269,267</u>
Total restricted net assets	<u>14,737,508</u>
Unrestricted net assets	<u>4,503,758</u>
Total net assets	<u>\$ 20,107,263</u>

Commitment and contingencies (note 13)

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

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

Functions/Programs	Expenses	Program Revenues			Net (expenses) and changes in net assets
		Charges for services	Program – specific operating grants and contributions	Program – specific capital grants and contributions	
Governmental activities:					
General government	\$30,731,919	2,830,185	1,700,401	3,653,340	\$(22,547,993)
Urban and economic development	8,717,198	-	-	-	(8,717,198)
Public safety	3,236,460	-	-	-	(3,236,460)
Health and sanitation	9,822,824	737,479	-	-	(9,085,345)
Culture, recreation and education	13,850,365	219,699	9,704,493	-	(3,926,173)
Public housing and welfare	7,167,815	162,409	5,281,896	45,765	(1,677,745)
Interest on long-term obligations	3,210,461	-	-	-	(3,210,461)
<b>Total governmental activities</b>	<b>\$76,737,042</b>	<b>3,949,772</b>	<b>16,686,790</b>	<b>3,699,105</b>	<b>(52,401,375)</b>
General revenues:					
Taxes:					
Property taxes					24,818,421
Municipal license taxes					17,875,387
Construction excise taxes					2,388,217
Total taxes					45,082,025
Grants and contributions, not restricted to specific programs					12,164,624
Unrestricted investment earnings					1,387,519
Miscellaneous					729,391
Special item – Puerto Rico Electric Power Authority					1,839,570
Total general revenues and special item					61,203,129
Net change in net assets					8,801,754
Net assets at beginning of year					11,305,509
Net assets at end of year					<u>\$20,107,263</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGUEZ**  
**Balance Sheet – Governmental Funds**  
**June 30, 2003**

	<b>Major Funds</b>					<b>Total governmental funds</b>
	<b>General Fund</b>	<b>State legislative joint resolutions special revenue fund</b>	<b>Head start special revenue fund</b>	<b>Debt service fund</b>	<b>Other governmental funds</b>	
<b>Assets</b>						
Cash in commercial banks	\$2,675,608	-	-	-	-	\$ 2,675,608
Accounts receivable, net of allowance for uncollectible accounts:						
Taxes:						
Property taxes	7,529,622	-	-	-	-	7,529,622
Municipal license taxes	2,300,467	-	-	-	-	2,300,467
Mortgage loans and notes	-	-	-	-	878,710	878,710
Accrued interest	34,070	-	-	10,382	18,785	63,237
Intergovernmental	2,503,994	-	219,273	-	1,871,261	4,594,528
Due from other funds	1,769,704	-	-	723,125	932,312	3,425,141
Advances from other funds	-	-	370,881	-	-	370,881
Other	1,265,658	-	3,266	-	832,685	2,101,609
Investments	19,000,000	-	-	-	-	19,000,000
Restricted assets:						
Cash in commercial banks	-	8,252,974	102,429	-	8,031,536	16,386,939
Cash in fiscal agent	2,690,111	-	-	13,268,168	6,939,807	22,898,086
Property taxes receivable, net of allowance for uncollectible accounts	-	-	-	2,394,471	-	2,394,471
<b>Total assets</b>	<b>\$39,769,234</b>	<b>8,252,974</b>	<b>695,849</b>	<b>16,396,146</b>	<b>19,505,096</b>	<b>\$ 84,619,299</b>
<b>Liabilities</b>						
Accounts payable	\$ 2,604,932	85,883	657,177	-	1,993,072	\$ 5,341,064
Intergovernmental	542,720	-	-	-	2,478	545,198
Due to other funds	917,177	-	1,187	30,884	2,475,893	3,425,141
Advances to other funds	370,881	-	-	-	-	370,881
Deferred revenues	23,021,804	8,163,918	37,344	2,148,024	3,084,786	36,455,876
Matured bonds due and payable	-	-	-	3,345,000	-	3,345,000
Matured interest due and payable	-	-	-	1,324,850	-	1,324,850
<b>Total liabilities</b>	<b>27,457,514</b>	<b>8,249,801</b>	<b>695,708</b>	<b>6,848,758</b>	<b>7,556,229</b>	<b>50,808,010</b>
<b>Fund balances</b>						
Reserved for:						
Encumbrances	1,643,357	-	-	-	-	1,643,357
Debt service	-	-	-	9,547,388	-	9,547,388
Capital projects	-	-	-	-	6,756,886	6,756,886
Advances and long-term receivables	-	-	370,881	-	872,544	1,243,425
Other specified purposes	2,204,937	3,173	-	-	4,319,437	6,527,547
Unreserved	8,463,426	-	(370,740)	-	-	8,092,686
<b>Total fund balances</b>	<b>12,311,720</b>	<b>3,173</b>	<b>141</b>	<b>9,547,388</b>	<b>11,948,867</b>	<b>33,811,289</b>
<b>Total liabilities and fund balances</b>	<b>\$39,769,234</b>	<b>8,252,974</b>	<b>695,849</b>	<b>16,396,146</b>	<b>19,505,096</b>	<b>\$ 84,619,299</b>

Commitments and contingencies (note 13)

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
Reconciliation of the Balance Sheet – Governmental Funds  
to the Statement of Net Assets  
June 30, 2003

Governmental activities' amounts reported in the statement of net assets and the balance sheet – governmental funds are different because:

Aggregate fund balance reported in the balance sheet – governmental funds	\$33,811,289
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Add (Deduct):

Inventories and other current assets are not available to pay current period expenditures, therefore are not reported in the governmental funds	154,340
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Capital assets used in governmental activities are not financial resources, therefore are not reported in the governmental funds	38,316,886
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Deferred revenues in the governmental funds that are recognized as revenues in the statement of activities	14,679,011
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Debt issued by <b>the Municipality</b> has associated costs that are paid from current available resources in the governmental funds. However, these costs are deferred in the statement of net assets	208,348
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The following liabilities are not due (mature) in the current period, therefore are not reported in the governmental funds:

Accounts payable and accrued liabilities	(4,026,731)
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Intergovernmental payables	(1,367,097)
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Bonds payable	(43,472,000)
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Notes payable, including bond anticipation notes	(7,304,231)
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Obligation under capital leases	(1,026,675)
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Compensated absences	(7,949,666)
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Claims and judgments	(500,786)
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Solid waste landfill closure and postclosure care costs	<u>(1,415,425)</u>
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Net assets – governmental activities reported in statement of net assets	<u>\$20,107,263</u>
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The accompanying notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ**

Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds  
Year Ended June 30, 2003

	Major Funds					Total governmental funds
	General fund	State legislative joint resolutions special revenue fund	Head start special revenue fund	Debt service fund	Other governmental funds	
<b>Revenues:</b>						
Taxes:						
Property taxes	\$19,760,824	-	-	4,631,457	-	\$ 24,392,281
Municipal license taxes	16,232,399	-	-	-	-	16,232,399
Construction excise taxes	2,388,217	-	-	-	-	2,388,217
Charges for services	2,664,733	-	-	-	-	2,664,733
Intergovernmental grants and contributions:						
United States of America	-	-	9,696,529	-	9,214,096	18,910,625
Commonwealth of Puerto Rico	11,442,275	660,509	4,179	-	894,887	13,001,850
Investment earnings	881,236	3,173	141	121,899	381,070	1,387,519
Miscellaneous	700,352	-	3,786	-	25,253	729,391
<b>Total revenues</b>	<b>54,070,036</b>	<b>663,682</b>	<b>9,704,635</b>	<b>4,753,356</b>	<b>10,515,306</b>	<b>79,707,015</b>
<b>Expenditures:</b>						
Current:						
General government	25,463,914	660,509	-	-	1,601,912	27,726,335
Urban and economic development	7,477,564	-	-	-	194,583	7,672,147
Public safety	3,048,692	-	-	-	-	3,048,692
Health and sanitation	8,665,766	-	-	-	-	8,665,766
Culture, recreation and education	3,323,733	-	10,336,271	-	-	13,660,004
Public housing and welfare	1,255,151	-	-	-	6,430,874	7,686,025
Debt service:						
Principal	1,143,479	-	-	3,437,000	-	4,580,479
Interest	219,676	-	-	2,801,760	-	3,021,436
Capital outlays:						
Roads and streets	-	-	-	-	556,595	556,595
Land acquisitions	-	-	-	-	1,566,378	1,566,378
Construction and remodeling of public facilities	123,290	-	-	-	2,671,332	2,794,622
Machinery, equipment and vehicles	453,995	-	-	-	51,900	505,895
<b>Total expenditures</b>	<b>51,175,260</b>	<b>660,509</b>	<b>10,336,271</b>	<b>6,238,760</b>	<b>13,073,574</b>	<b>81,484,374</b>
Excess (deficiency) of revenues over (under) expenditures	2,894,776	3,173	(631,636)	(1,485,404)	(2,558,268)	(1,777,359)
<b>Other financing sources (uses):</b>						
Transfers-in from other funds	3,069,282	-	631,777	1,111,901	1,908,563	6,721,523
Transfers-out to other funds	(2,037,152)	-	-	(1,621,899)	(3,062,472)	(6,721,523)
Proceeds from issuance of bond anticipation notes	-	-	-	-	47,975	47,975
Capital leases	256,965	-	-	-	-	256,965
<b>Total other financing sources (uses), net</b>	<b>1,289,095</b>	<b>-</b>	<b>631,777</b>	<b>(509,998)</b>	<b>(1,105,934)</b>	<b>304,940</b>
<b>Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses</b>	<b>4,183,871</b>	<b>3,173</b>	<b>141</b>	<b>(1,995,402)</b>	<b>(3,664,202)</b>	<b>(1,472,419)</b>
<b>Fund Balance at beginning of year, as restated</b>	<b>8,127,849</b>	<b>-</b>	<b>-</b>	<b>11,542,790</b>	<b>15,613,069</b>	<b>35,283,708</b>
<b>Fund Balance at end of year</b>	<b>\$12,311,720</b>	<b>3,173</b>	<b>141</b>	<b>9,547,388</b>	<b>11,948,867</b>	<b>\$ 33,811,289</b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**Reconciliation of Statement of Revenues, Expenditures and Changes**  
**in Fund Balances - Governmental Funds to the Statement of Activities**  
**Year ended June 30, 2003**

Governmental activities' amounts reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds are different because:

Net change in fund balances reported in statement of revenues, expenditures and changes in fund balances - governmental funds	\$ (1,472,419)
Add (Deduct):	
The following revenues recorded in the statement of activities do not provide current financial resources, therefore are deferred in the governmental funds:	
Property taxes	426,140
Municipal license taxes	1,642,988
Charges for services	1,285,039
Special item - Puerto Rico Electric Power Authority	1,839,570
Intergovernmental grants and contributions	638,044
Governmental funds report capital outlays as expenditures. However in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expense. This is the amount by which capital outlay expenditures exceeded depreciation and amortization expense.	1,405,500
Repayment of principal of long-term obligations is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets	4,580,479
Certain interest reported in the statement of activities do not require the use of current financial resources, therefore are not reported as expenditures in the governmental funds	(189,025)
Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore are not reported as expenditures in the governmental funds	(20,048)
Some expenses reported in the statement of activities do not require the use of current financial resources, therefore are not reported as expenditures in the governmental funds	(1,372,155)
Generally, inventory and other current assets are recorded as expenditures in the governmental Funds when paid rather than capitalized as an asset. However these assets are capitalized in the statement of net assets. This amount represents the net change in these assets for the year.	85,616
Proceeds from issuance of bond anticipation notes provide current financial resources to governmental funds, but issuing such debt increases long-term liabilities in the statement of net assets	(47,975)
Net change in net assets reported in statement of activities	<u>\$ 8,801,754</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**Statement of Revenues and Expenditures – Budget and Actual –**  
**Budgetary basis – General Fund**  
**Year ended June 30, 2003**

	Budgeted amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget - over (under)
	Original	Final		
<b>Revenues:</b>				
Property taxes	\$ 19,942,288	19,942,288	19,942,288	\$ -
Municipal license taxes	13,550,000	13,550,000	16,223,033	2,673,033
Construction excise taxes	1,915,000	1,915,000	2,388,217	473,217
Charges for services	3,570,061	3,570,061	2,499,551	(1,070,510)
Intergovernmental grants and contributions	5,051,101	5,051,101	4,839,296	(211,805)
Investment earnings	2,260,000	2,260,000	895,776	(1,364,224)
Miscellaneous	1,830,000	3,129,392	700,352	(2,429,040)
Total revenues	<u>48,118,450</u>	<u>49,417,842</u>	<u>47,488,513</u>	<u>(1,929,329)</u>
<b>Expenditures:</b>				
Current:				
General government	18,562,651	18,861,121	15,016,720	3,844,401
Urban and economic development	7,488,115	8,622,483	8,403,220	219,263
Public safety	4,114,114	3,569,355	3,308,911	260,444
Health and sanitation	8,270,494	8,484,707	8,269,152	215,555
Culture, recreation and education	4,234,736	4,669,906	4,311,806	358,100
Public housing and welfare	2,056,952	1,818,882	1,375,234	443,648
Debt service:				
Principal	1,143,479	1,143,479	1,143,479	-
Interest	219,676	219,676	188,288	31,388
Capital outlays:				
Construction and remodeling of public facilities	123,290	123,290	123,290	-
Machinery, equipments and vehicles	453,995	453,995	453,995	-
Total expenditures	<u>46,667,502</u>	<u>47,966,894</u>	<u>42,594,095</u>	<u>5,372,799</u>
<b>Excess of revenues over expenditures</b>	<u>1,450,948</u>	<u>1,450,948</u>	<u>4,894,418</u>	<u>3,443,470</u>
<b>Other financing sources (uses):</b>				
Transfers-in from other funds	-	-	3,069,282	3,069,282
Transfers-out to other funds	(1,450,948)	(1,450,948)	(2,037,152)	(586,204)
Capital leases	-	-	256,965	256,965
Total other financing sources (uses), net	<u>(1,450,948)</u>	<u>(1,450,948)</u>	<u>1,289,095</u>	<u>2,740,043</u>
<b>Excess of revenues and other financing sources over expenditures and other finances uses</b>	<u>\$ -</u>	<u>-</u>	<u>6,183,513</u>	<u>\$ 6,183,513</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGÜEZ**  
**Budgetary Comparison Schedule – Debt Service Fund**  
**Year ended June 30, 2003**

	Budgeted amounts		Actual amounts (budgetary basis)	Variance with final budget – Over (under)
	Original	Final		
<b>Revenues:</b>				
Property taxes	\$ 5,693,289	5,693,289	4,558,347	\$ (1,134,942)
Interest	-	-	124,080	124,080
Transfers from other funds	-	-	1,093,401	1,093,401
Total revenues and transfers from other funds	<u>5,693,289</u>	<u>5,693,289</u>	<u>5,775,828</u>	<u>82,539</u>
<b>Expenditures:</b>				
<b>Debt service:</b>				
Principal	3,151,970	3,151,970	3,547,000	395,030
Interest	2,541,319	2,541,319	2,959,626	418,307
Transfers to other funds	-	-	1,625,727	1,625,727
Total expenditures and transfers to other funds	<u>\$ 5,693,289</u>	<u>5,693,289</u>	<u>8,132,353</u>	<u>\$ 2,439,064</u>

**Reconciliation of differences:**

**Sources/inflows of financial resources:**

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 5,775,828
<b>Differences - budgetary basis to GAAP:</b>	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(1,093,401)
<b>Differences in bases of accounting:</b>	
Net increase in property tax receivable	94,267
Net decrease in accrued interest receivable	(2,181)
Net increase in deferred revenues	(21,157)
Total revenues as reported on the statement of revenues, Expenditures and changes in fund balances - governmental funds	<u>\$ 4,753,356</u>

**Uses/outflows of financial resources:**

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	8,132,353
<b>Differences - budgetary basis to GAAP:</b>	
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(1,625,727)
<b>Differences in bases of accounting:</b>	
Net decrease in matured bonds due and payable	(110,000)
Net decrease in matured interest due and payable	(157,866)
Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 6,238,760</u>

See accompanying notes to budgetary comparison schedule – debt service fund.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**The Municipality of Mayagüez (the Municipality)** is a local municipal government located in the Commonwealth of Puerto Rico (the Commonwealth) and constituted on July 29, 1760, with full legislative, fiscal and all other governmental powers and responsibilities not expressly assigned to the government of 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.

*a) New Financial Reporting Model*

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).

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 on 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*a) New Financial Reporting Model (Continuation)*

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) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

The RSI is information presented along with, but separate from, **the Municipality's** basic financial statements. 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).

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 schedule of funding progress – Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities provides a 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 (see note 12).

Other supplementary information consisting of combining and individual governmental fund financial statements, the budgetary comparison schedule – debt service fund, and the schedules of capital assets used in the operations of governmental funds, as listed in the accompanying table of contents, are presented in this report for purposes of additional analysis.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

a) *New Financial Reporting Model* (Continuation)

As previously mentioned, on July 1, 2002, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (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, in conjunction and 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.

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 14).

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*b) Financial Reporting Entity (Continuation)*

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 basic 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.

*c) Government-wide Financial Statements*

The accompanying 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** 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 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*c) Government-wide Financial Statements (Continuation)*

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). 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 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, reduced by the outstanding balances of bonds, notes and 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*c) Government-wide Financial Statements (Continuation)*

- **Restricted net assets** (Continuation) - The classification of restricted net assets identifies 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 are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints 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 a 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) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) 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:

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)**

*c) Government-wide Financial Statements (Continuation)*

**General government:**

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of legal affairs
- Department of internal audit
- Department of management of information systems
- Department of administrative services
- Department of press and communications

**Urban and economic development:**

- Department of planning and development
- Department of urban development
- Department of conservation and ornate

**Public safety:**

- Department of civil defense
- Department of municipal police
- Department of fire control

**Health and sanitation**

- Department of health
- Department of sanitation
- Department of environmental control

**Culture, recreation and education:**

- Department of culture and tourism
- Department of recreation and sports
- Department of education

**Public housing and welfare:**

- Department of housing
- Office of services to citizens

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*c) Government-wide Financial Statements (Continuation)*

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. 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 citizens. In the statement of activities, program revenues reduce the costs (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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

c) *Government-wide Financial Statements* (Continuation)

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 not restricted for specific programs, and miscellaneous revenues) 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 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 governmental 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 Municipality** has no 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 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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*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. Some of these financial statements 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 (one fiscal 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 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** main 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. 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 governmental fund other than the general fund.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

d) *Governmental Fund Financial Statements* (Continuation)

- *Special revenue funds* – The special revenue funds are major and nonmajor funds, as defined below, 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. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund's liabilities at June 30, if resources are available at June 30 for its payment.

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 care costs, among others) are accounted for in the accompanying statement of net assets. The debt service payments of such debts are accounted for in the general fund.

- *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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

d) *Governmental Fund Financial Statements* (Continuation)

- *Capital projects funds* (Continuation) –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.
  
- *Permanent funds* – Permanent funds are the newest governmental fund type, first introduced as part of the financial reporting model established by GASB No. 34. Permanent funds are non major funds used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support **the Municipality's** programs, that is, for the benefit of the government or its citizens.

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 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 non major within the governmental fund financial statements. Major individual governmental funds are reported individually as separate columns in the governmental fund financial statements, while data from all non major 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 non operating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes means all expenditures, including operating and non operating expenditures, except for other financing uses.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*d) Governmental Fund Financial Statements (Continuation)*

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 state legislative joint resolutions special revenue fund, (3) the head start special revenue fund and (4) the debt service fund.

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 subsidy 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.

The head start special revenue fund is a major fund used to account for certain financial resources derived from operating grants awarded each year by the Administration for Children and Families of the U.S. Department of Health and Human Services (DHHS). Amounts awarded by DHHS in this grant award are restricted to provide comprehensive health, educational, nutritional, social and other developmental services primarily to economically-disadvantaged preschool children (ages 3 to 5) and infants and toddlers (birth through age 3) so that the children will attain school readiness in educational centers approved by DHHS for the Municipalities of Mayagüez, Las Marias, Maricao, Añasco and Hormigueros.

*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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

e) *Measurement Focus and Basis of Accounting* (Continuation)

**Government-wide financial statements** (Continuation) – 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 non exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non exchange Transactions* (GASB No. 33), which **the Municipality** adopted on July 1, 2002. GASB No. 33 established accounting and reporting standards for non exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non exchange 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 non exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non exchange revenues, (c) government mandated non exchange transactions, and (d) voluntary non exchange 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 are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place).

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

e) *Measurement Focus and Basis of Accounting* (Continuation)

**Government-wide financial statements** (Continuation) – In the case of imposed non exchange 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.

Government-mandated non exchange transactions (such as 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, **the Municipality** must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary non exchange 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 types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non exchange transactions discussed above.

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues (see note 10).

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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*e) Measurement Focus and Basis of Accounting (Continuation)*

**Government-wide financial statements** (Continuation) – 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 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 criterion or collected in advance are recorded as deferred revenues at June 30, 2003 (see note 10). The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and investment earnings. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

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.

All revenues, expenses, gains, losses and assets resulting from non exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non exchange transactions, 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

COMMONWEALTH OF PUERTO RICO  
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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

e) *Measurement Focus and Basis of Accounting* (Continuation)

Governmental fund financial statements (Continuation) – 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 these 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 consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- 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).

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*e) Measurement Focus and Basis of Accounting* (Continuation)

**Governmental fund financial statements** (Continuation)

- Obligations under capital leases, solid waste landfill closure and post closure care costs, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available and expendable financial resources are recorded in the accompanying statement of net assets but not in the governmental funds.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

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 recorded in the accompanying statement of activities, but are not recorded 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 accompanying statement of net assets.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*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 annual budgets each fiscal year for **the Municipality's** general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source for both funds. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates 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 preliminary 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 June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets 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 approves 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 budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, 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.

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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*f) Stewardship, Compliance and Accountability* (Continuation)

**Budgetary Control** (Continuation)

The annual budgets 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 budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. 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. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

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 budgets are prepared under the budgetary (statutory) 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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*f) Stewardship, Compliance and Accountability* (Continuation)

**Budgetary Accounting** (Continuation)

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.

The accompanying statement of revenues and expenditures – budget and actual – budgetary basis – general fund, provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2003. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2003, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

Because accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the budgetary basis and GAAP actual amounts is presented for the general fund as follows:

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*f) Stewardship, Compliance and Accountability* (Continuation)

**Budgetary Accounting** (Continuation)

Excess of revenues and other financing sources over expenditures and other financing uses – budgetary basis	\$ 6,183,513
Timing differences:	
Add:	
Current year encumbrances recorded as expenditures for budgetary purposes	1,643,357
Deduct:	
Prior year encumbrances recorded as current year expenditures for GAAP purposes	(4,468,802)
Entity differences:	
Non-budgeted expenditures	(692,240)
Basis of accounting differences:	
Net increase in property tax receivable	479,035
Net decrease in municipal license tax receivable	(2,604,038)
Net increase in intergovernmental receivables	2,329,373
Net decrease in accrued interest receivable	(14,540)
Net increase in other receivables	41,574
Net increase in due from other funds	390,213
Net decrease in deferred revenue	1,365,529
Net increase in accounts payable	(207,460)
Net increase in intergovernmental payables	(364,216)
Net decrease in due to other funds	102,573
Excess of revenues and other financing sources over	
over expenditures and other financing uses (GAAP basis)	\$ 4,183,871

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*f) Stewardship, Compliance and Accountability (Continuation)*

**Budgetary Accounting** (Continuation)

The Municipality does not legally adopt budgets for its major special revenue funds: (1) the state legislative joint resolutions special revenue fund and (2) the head start special revenue fund. The financial resources received by the state legislative joint resolutions special revenue fund and the head start special revenue fund are not subject to budgeting by the Municipality since the grants awarded each year by the respective grantors vary from year to year and the respective amounts are granted at their discretion.

*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 exceeding three months but limited to one year.

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 by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Restricted assets consist of cash in commercial banks and GDB. These cash balances are classified as restricted assets since its use is limited for the specified purposes discussed below, which are established by applicable agreements or required by law.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*g) Unrestricted and Restricted Deposits (Continuation)*

Cash with fiscal agent in the general and debt service funds represent property tax collections amounting to \$723,125 and \$13,268,168, respectively, which are retained and restricted for the payment of **the Municipality's** debt service, as established by law. Cash in fiscal agent in the general fund also consists of restricted unspent proceeds, of bonds, amounting to \$1,966,986 issued to pay certain accounts payable and certain specific commitments, previously agreed with and approved by GDB. Cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and non interest bearing accounts, amounting to \$6,939,807, which are restricted for: (1) the acquisition, construction or improvement of major capital assets (\$6,755,392) recorded in non major capital projects funds, (2) the operations of federal and state funded programs (\$184,415) recorded in non major special revenue funds.

Restricted cash in commercial banks for the state legislative joint resolutions special revenue fund and the head start special revenue fund, amounting to \$8,252,974 and \$102,429, respectively, represent the balance of interest and non interest bearing accounts restricted to finance the operations of these state and federally funded programs. Restricted cash in commercial banks for other governmental funds, amounting to \$8,031,536, represents the balance of interest and non interest bearing accounts restricted to: (1) finance the operations of all federal and state funded programs (\$7,912,723) recorded in non major special revenue funds, (2) grant mortgage loans under the Program for the Economic Development of Mayagüez (\$117,319) recorded in non major permanent fund (see note 6), and (3) finance the acquisition, construction and improvement of major capital assets (\$1,494) recorded in non major capital projects fund.

*h) Unrestricted and Restricted Accounts and Notes 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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*h) Unrestricted and Restricted Accounts and Notes Receivable (Continuation)*

Mortgage loans and notes receivable in other governmental funds represent long-term loans granted to private entities and individuals under the Program for the Economic Development of Mayagüez, sponsored by **the Municipality** (see note 6).

Intergovernmental receivables are composed of: (1) amounts owed to **the Municipality** for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the special revenue funds) and (2) a lawsuit settlement amount (recorded in the general fund) due from the Puerto Rico Electric Power Authority (PREPA), pursuant to a claim filed in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years (see notes 5 and 16).

Other receivables recorded in the general fund include a receivable amounting to \$1,000,000 from Advance Cardiology Center Corporation, which is net of an allowance for uncollectible accounts of \$4,030,396 since its collection at June 30, 2003 is uncertain (see note 7).

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. The allowance for uncollectible accounts recorded in the accompanying GWFS and GFFS amounted to \$39,361,284.

Activities among 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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*i) Inventories and Other Current Assets*

Inventories and other current assets consist of materials, supplies, food and medicine inventories held for consumption; and prepaid expenses amounting to \$151,441 and \$2,899, respectively. Generally, inventories are capitalized (consumption method) and stated at cost using the first-in, first-out method (FIFO) in the GWFS. Inventories and prepaid expenses in the GFFS are recorded as expenditures (purchase method) when purchased (paid) rather than capitalized as an asset.

*j) Investments*

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

*k) Deferred Charges*

Deferred charges capitalized in the accompanying statement of net assets consist of bond issuance costs, net of accumulated amortization. Deferred charges are amortized over the term of the related debt using the straight-line method. In the GFFS, bond issuance costs are recognized in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

*l) 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 statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

**The Municipality** defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with 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.

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)**

*1) Capital Assets (Continuation)*

In the 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 statement of net assets 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.

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:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*l) Capital Assets* (Continuation)

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.

*m) 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 (60 days for property taxes) thereafter to pay obligations due at June 30, or;
- **The Municipality** receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, 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.

*n) 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 off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying 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 includes 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).

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*n) Compensated Absences* (Continuation)

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). Employees accumulate compensatory time 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 is not paid to the employee, if not consumed. 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 employee 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.

*o) Long-term Debt*

The long-term liabilities reported in the accompanying statements of net assets include **the Municipality's** bonds, notes, bond anticipation notes, obligation under capital leases, compensated absences, liability for municipal solid waste landfill closure and postclosure care costs and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due in July 1 of the following fiscal year, are recorded as fund liabilities in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*o) Long-term Debt* (Continuation)

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 such costs are recognized as expenditures during the current period.

On July 1, 2002, **the Municipality** adopted the provisions of APB Opinion No. 21, *Interest on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to the U.S. Department of Housing and Urban Development (HUD) (see note 11). According to APB No. 21, **the Municipality** has recorded such 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, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The notes discount is amortized over the life of the notes using the effective interest method. Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

*p) Municipal Solid Waste Landfill Closure and Post closure Care Costs*

Solid waste landfill closure and post closure care costs are accounted for under the provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Post closure Care Costs*, issued by GASB (GASB No. 18).

The estimated liability for solid waste landfill closure and post closure care costs (including monitoring and maintenance) includes an estimate of all costs to be incurred near or after the close of **the Municipality's** solid waste landfill. In the government-wide statement of net assets, this liability is recognized under the accrual basis of accounting, over the useful life of the landfill, even though such costs will only be incurred near or after the close of the landfill.

The estimates of closing and post closing costs include: (1) the cost of equipment and facilities that will be acquired near the time the landfill stops accepting waste or after for the purpose of post closure care and monitoring, (2) the cost of applying the final cover and (3) the cost of post closure maintenance and monitoring. These cost estimates are made using current costs (costs that would be incurred if these services would have been obtained during the current period). The liability is adjusted annually to reflect the effects of inflation, advances in technology, changes in regulations or similar changes.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*p) Municipal Solid Waste Landfill Closure and Post closure Care Costs* (Continuation)

In the GFFS, solid waste landfill closure and post closure care costs are recorded in the accounting period in which they are due (when they mature) under the modified accrual basis of accounting.

*q) Leases*

**The Municipality** classifies its lease agreements either as operating or capital leases. Capital lease agreements are non-cancelable and involve, substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease liability at the inception of the lease. According to GAAP, **the Municipality** classifies a lease agreement as a capital lease if at its inception the lease meets one or more of the following four criteria:

- By the end of the lease term, ownership of the leased property is transferred to **the Municipality**.
- The lease agreement contains a bargain purchase option.
- The lease term is substantially equal (75% or more) to the estimated useful life of the leased property.
- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90% or more of the fair value of the leased property.

Although **the Municipality** is prevented legally from entering into obligations extending beyond the current year budget, most capital lease agreements entered by **the Municipality** contain fiscal funding clauses or a cancellation clause that makes the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have fiscal funding or cancellation clauses have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered to be remote. **The Municipality's** lease agreements do not include contingent rental payments nor escalation clauses.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

*q) Leases (Continuation)*

In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executory costs and profit thereon to be paid by the lessor. A portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease liability using the effective interest method.

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as (1) expenditure and (2) other financing source. Minimum lease payments are recorded as expenditures in the GFFS.

*r) 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 the majority of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to **the Municipality** in the accompanying basic financial statements. The basic financial statements of the Commonwealth account for the total amount of the net pension obligation of ERS, 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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

s) *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 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 ("CRIM", by its Spanish acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

**The Municipality** carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), 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 ACAA.

**The Municipality** obtains workers' compensation insurance coverage through the State Insurance Fund Corporation ("FSE" by its Spanish acronym), 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** obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for 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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

s) *Risk Management* (Continuation)

The **Municipality** also obtains medical insurance coverage for its 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.

t) *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.
- *Advances and long-term receivables* – Represent the reservation of resources set aside for long-term accounts, notes and interfund receivables, which are not considered current available financial resources.
- *Other Specified Purposes* – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds, and resources available in the general fund for the payment of certain accounts payable and commitments approved by GDB.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

u) *Interfund Activities*

Permanent reallocations of resources among the Municipality's funds are classified as interfund transfers. The Municipality has the following types of activities recorded among funds in the accompanying 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 Activities* – Represent transfers among funds that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- *Advances* – Represent amounts advanced among funds, which are not considered to be currently available financial resources.

In the GFFS, interfund activity has not been eliminated, as permitted by GAAP.

v) *Reclassifications*

As part of the adoption of GASB No. 34, the Municipality revised the classifications of its governmental funds, which resulted in the reclassification of two governmental funds in accordance with GAAP. The following table summarizes the effects of these reclassifications, by fund type, made in the accompanying GFFS:

<b>Fund classifications, as reported in 2002 <u>financial statements</u></b>	<b>Non major fund classifications, as restated</b>	<b>Fund balance, as reported in 2002 <u>financial statements</u></b>
Nonexpendable trust fund – Mayagüez economic development fund	Permanent fund	<u>\$ 1,178,226</u>
Special revenue fund reported within general fund – State salary incentive fund	Special revenue fund	<u>\$ 179,227</u>

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

v) *Reclassifications* (Continuation)

The effects of the governmental fund reclassifications referred to above have been reported as restatements of fund balances at July 1, 2002 in the accompanying GFFS (see note 14).

w) *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.

x) *Future Adoption of Accounting Pronouncements*

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.

2. DEPOSITS AND INVESTMENTS

**The Municipality** maintains its deposits of cash in various commercial banks located in Puerto Rico and GDB. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation ("FDIC") up to a maximum of \$100,000 per depositor.

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**2. DEPOSITS AND INVESTMENTS (Continuation)**

Under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amounts deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury's agents in **the Municipality's** name.

**The Municipality's** bank balances of deposits with financial institutions are categorized to provide an indication of the level of custodial credit risk assumed by **the Municipality** at year-end. 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 the pledging financial institution's trust department or agent in **the Municipality's** name.
- Category 3:** Uncollateralized (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in **the Municipality's** name).

The carrying amount of deposits in financial institutions at June 30, 2003 consists of the following:

	<u>Major funds</u>					<u>Total</u>
	<u>General fund</u>	<u>State legislative joint resolutions special revenue fund</u>	<u>Head start special revenue fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	
Unrestricted:						
Deposits in commercial banks	\$2,675,608	-	-	-	-	\$2,675,608
Restricted (note 1):						
Deposits in commercial banks	-	8,252,974	102,429	-	8,031,536	16,386,939

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**2. DEPOSITS AND INVESTMENTS (Continuation)**

Deposits in GDB, as fiscal agent	2,690,111	-	-	13,268,168	6,939,807	22,898,086
Total carrying amount of deposits	<u>\$5,365,719</u>	<u>8,252,974</u>	<u>102,429</u>	<u>13,268,168</u>	<u>14,971,343</u>	<u>\$41,960,633</u>

The bank balance of deposits with financial institutions at June 30, 2003 consists of the following:

	<u>Major funds</u>					<u>Total</u>
	State legislative joint resolutions		Head start special revenue fund	Debt service fund	Other governmental funds	
	<u>General fund</u>	<u>special revenue Fund</u>				
Unrestricted:						
Category 3:						
Deposits in commercial banks	\$5,119,687	-	-	-	-	\$5,119,687
Restricted (note 1):						
Category 3:						
Deposits in commercial banks	-	8,306,995	269,314	-	8,502,706	17,079,015
Category 3:						
Deposits in GDB, as fiscal agent	2,690,111	-	-	13,268,168	6,938,743	22,897,022
Total bank balances	<u>\$7,809,798</u>	<u>8,306,995</u>	<u>269,314</u>	<u>13,268,168</u>	<u>15,441,449</u>	<u>\$45,095,724</u>

Pursuant to the Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico, **the Municipality** may invest in obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico.

**The Municipality's** investments are categorized to provide an indication of the level of custodial credit risk assumed by **the Municipality** at year-end. Risk categories are described as follows:

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**2. DEPOSITS AND INVESTMENTS (Continuation)**

- Category 1:** Insured or registered, or securities held by **the Municipality** or the Secretary of the Treasury's agent in **the Municipality's** name.
- Category 2:** Uninsured and unregistered, with securities held by the counterparty's trust department or agent in **the Municipality's** name.
- Category 3:** Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent, but not in **the Municipality's** name.

Custodial credit risk classifications for short-term investments are as follows:

	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	<u>Carrying amount</u>	<u>Bank balance</u>	<u>Estimated fair value</u>
Unrestricted – negotiable certificates of deposit \$	-	-	19,000,000	19,000,000	19,000,000	\$19,000,000

The carrying amount of investments in certificates of deposit approximate its estimated fair value due to the short-term nature of these investments and the lack of restrictions over them. In addition, these investments bear interest at the prevailing market rates for these types of investments. This interest is used by **the Municipality** to support its programs.

**3. MUNICIPAL LICENSE TAXES**

**The Municipality** is authorized by law to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Mayagüez. This is a self-assessed tax generally based on the business volume measured by gross sales. **The Municipality** establishes the applicable tax rates. At June 30, 2003, the municipal tax rates imposed by **the Municipality** were 1.50% for financing institutions and 0.50% for other types of taxpayers. Any taxpayers that 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% under standard rates.

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**3. MUNICIPAL LICENSE TAXES (Continuation)**

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15 based on the actual volume of business generated in the preceding calendar year. Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Total municipal license tax receivable, net of an allowance for uncollectible accounts of \$839,106, amounted to \$2,300,467 at June 30, 2003. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$10,490,817 and \$12,133,805, respectively at June 30, 2003. Municipal license revenues recorded in the accompanying GWFS and GFFS amounted to \$17,875,387 and \$16,232,399, respectively, for the year ended June 30, 2003.

**4. PROPERTY TAXES**

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

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2003 was 6.23% (of which taxpayers pay 6.03% and 0.20% is reimbursed by the Department of Treasury). 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 to 1957 market prices. The total real property tax rate in force at June 30, 2003 was 8.23% (of which 8.03% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

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4. PROPERTY TAXES (Continuation)

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 assumes payment of the basic tax (4% and 6% 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.

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of **the Municipality**. Prior to the beginning of each fiscal year, CRIM informs **the Municipality** of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to **the Municipality** based on the initial estimated collections. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to **the Municipality** and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than each December 31. If CRIM remits to **the Municipality** property tax advances, which are less than the property tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30. For the fiscal year ended June 30, 2003, the advances remitted by CRIM exceed the actual property tax collections in the amount of \$275,407, which are recorded within intergovernmental payables at June 30, 2003 (see note 5).

Law No. 83 of August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. Such special tax is levied by the Commonwealth but is collected by CRIM. Collections of this special tax are remitted to the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth.

In addition, 1.40% of the total personal and real property taxes collected by CRIM is restricted for **the Municipality's** debt service requirements and is retained by GDB for such purposes.

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:

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**4. PROPERTY TAXES (Continuation)**

- 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 maximum 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% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

Total property tax receivable, net of an allowance for uncollectible accounts of \$34,415,903, amounted to \$9,924,093 at June 30, 2003 (of which \$2,394,471 are restricted for the payment of the Municipality's debt service). Deferred property tax revenues recorded in the accompanying GFFS amounted to \$9,361,206 at June 30, 2003. Property tax revenues recorded in the accompanying GWFS and GFFS amounted to \$24,818,421 and \$24,392,281, respectively, for the year ended June 30, 2003.

**5. INTERGOVERNMENTAL RECEIVABLES AND PAYABLES**

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS at June 30, 2003 are as follows:

	<b>Major funds</b>	<b>Other governmental funds</b>	<b>Total governmental funds</b>	<b>Statement of net assets</b>
<i>Intergovernmental receivables:</i>				
Grants and contributions:				
U.S. Department of Health and Human Services:				
Head start special revenue fund	\$ 219,273	-	219,273	\$ 219,273
Child care USDA food fund	-	76,204	76,204	76,204

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**5. INTERGOVERNMENTAL RECEIVABLES AND PAYABLES (Continuation)**

	Major funds	Other governmental funds	Total governmental funds	Statement of net assets
Head start summer camp fund	-	4,112	4,112	4,112
Federal Emergency Management Agency: Public assistance grant fund	-	684,387	684,387	684,387
U.S. Department of Housing and Urban Development (HUD): HOME program fund	-	115,868	115,868	115,868
CDBG program fund	-	260,344	260,344	260,344
Office of the Governor of Puerto Rico - Felices Diaz special community fund	-	239,800	239,800	239,800
Puerto Rico Department of Labor: State salary incentives fund	-	490,546	490,546	490,546
Puerto Rico Treasury Department - general fund	204,531	-	204,531	204,531
Puerto Rico Electric Power Authority - special item - general fund (note 16)	2,299,463	-	2,299,463	2,299,463
Total intergovernmental receivables	<u>\$2,723,267</u>	<u>1,871,261</u>	<u>4,594,528</u>	<u>\$4,594,528</u>

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**5. INTERGOVERNMENTAL RECEIVABLES AND PAYABLES (Continuation)**

	<b>Major funds</b>	<b>Other governmental funds</b>	<b>Total governmental funds</b>	<b>Statement of net assets</b>
<i>Intergovernmental payables:</i>				
Excess of property tax advances over collections:				
CRIM – General fund (note 4)	\$ 275,407	-	275,407	\$ 275,407
Payroll withholdings (General fund):				
Puerto Rico Treasury Department	66,621	-	66,621	66,621
Puerto Rico Child Support Administration	5,159	-	5,159	5,159
Employees Retirement System of the Government of Puerto Rico and Its Instrumentalities	147,307	-	147,307	224,317
Commonwealth of Massachusetts	163	-	163	163
Utilities (General fund):				
Puerto Rico Aqueduct and Sewer Authority	27,478	-	27,478	54,069
Puerto Rico Electric Power Authority	20,585	-	20,585	1,280,876
Miscellaneous:				
General Services Administration of the Commonwealth of Puerto Rico	-	-	-	3,205
U.S. Department of Health and Human Services:				
Child Care USDA food fund	-	2,478	2,478	2,478
<b>Total intergovernmental payables</b>	<b>\$ 542,720</b>	<b>2,478</b>	<b>545,198</b>	<b>\$1,912,295</b>

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**6. MORTGAGE LOANS AND NOTES RECEIVABLE**

**The Municipality** administers the Program for the Economic Development of Mayagüez, by which mortgage loans have been given by **the Municipality** to various real estate developers doing business in Mayagüez. These loans are funded with grants received by **the Municipality** from HUD, which are accounted for in the Mayagüez economic development fund, a non major permanent fund. The proceeds of these loans are used by real estate developers to perform construction activities directed to enhance the economic activity in the Mayagüez area. These loans are repaid in installments of principal and interest through periods ranging from 10 to 20 years and are guaranteed with first liens on the related properties. Interest income on the aforementioned mortgage loans may be used by **the Municipality** to grant additional loans and for purposes that support certain qualifying municipal programs or activities that are for the benefit of **the Municipality** and its citizens.

Total outstanding loan balances and the related accrued interest receivable amounted to \$878,710 and \$8,417, respectively, at June 30, 2003. The total outstanding loan balances are offset by a reservation of fund balance of \$872,544 in the accompanying GFFS to indicate the portion of the loans that do not constitute available expendable financial resources at June 30, 2003. Interest income on such loans amounted to \$10,151 for the year ended June 30, 2003.

**7. MUNICIPAL HEALTH FACILITIES**

In August 1998, **the Municipality** entered into an administration agreement with Hospital San Antonio, Inc., a private corporation, for the administration of the operations of such hospital. The agreement expires on August 2003, however, **the Municipality** is currently in the process of negotiating the renewal of the agreement. The rent receivable from Hospital San Antonio, Inc. amounted to \$212,489 at June 30, 2003, which is recorded in the GWFS and the general fund, within other receivables. Rental income and other charges amounted to \$432,179 and \$261,356, respectively, for the year ended June 30, 2003, which are also recorded in the GWFS and the general fund within charges for services.

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**7. MUNICIPAL HEALTH FACILITIES (Continuation)**

In 2000, **The Municipality** acquired the facilities of the Ramón Emeterio Betances Hospital (REBH). As part of the acquisition, on October 1, 2000, **the Municipality** entered into an administration agreement of such facilities with Advance Cardiology Center Corporation (ACCC), a private corporation. The agreement provides for semiannual rental payments of \$450,000 to be made to **the Municipality** on each April and October. However, although **the Municipality** has been performing strong collection efforts no collections had been received, at June 30, 2003, since the inception of the agreement.

During 2002 **the Municipality** condoned \$900,000 of past due rent charges related to the first year of operations of ACCC in the REBH, and agreed to renegotiate the past due rent and other charges through a payment plan by which ACCC would pay the rent charges made from October 1, 2001 to date. At June 30, 2003, an accounts receivable from ACCC, amounting to \$5,030,396 has been recorded in the accompanying basic financial statements. Such receivable includes a receivable of \$3,455,396 for utilities paid by **the Municipality** related to the REBH facilities, which ACCC's is contractually required to reimburse to **the Municipality**. Because of the uncertainty of its collection, the receivable from ACCC, has been reduced by an allowance for uncollectible accounts of \$4,030,396 at June 30, 2003.

At June 30, 2003, deferred revenue amounting to \$1,000,000 has been recorded in the accompanying GFFS for the portion of the net receivable from ACCC that's not considered a current available financial resource at year-end.

**8. INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS**

The composition of interfund balances at June 30, 2003 and for the year then ended is as follows:

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8. INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS (Continuation)

Due/advances to:	Due/advances from:						
	Major funds					Non major	Total government al funds
	General fund	State legislative joint resolutions Special revenue fund	Head start special revenue fund	Debt service fund	special revenue funds		
Major funds:							
General fund	\$ -	-	370,881	723,125	194,052	\$ 1,288,058	
Head start special revenue fund	-	-	-	-	1,187	1,187	
Debt service fund	30,884	-	-	-	-	30,884	
Non major funds:							
Permanent fund	-	-	-	-	70,000	70,000	
Capital projects funds	9,291	-	-	-	-	9,291	
Special revenue funds	1,729,529	-	-	-	667,073	2,396,602	
Total	\$ 1,769,704	-	370,881	723,125	932,312	\$ 3,796,022	

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**8. INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS (Continuation)**

<b>Transfers to:</b>	<b>Transfers from:</b>						
	<b>Major funds</b>					<b>Non major special revenue funds</b>	<b>Total government al funds</b>
	<b>General fund</b>	<b>State legislative joint resolutions Special revenue fund</b>	<b>Head Start special revenue fund</b>	<b>Debt service fund</b>			
Major funds:							
General fund	\$ -	-	631,777	1,005,375	400,000	\$2,037,152	
Debt service fund	121,899	-	-	-	1,500,000	1,621,899	
Nonmajor funds:							
Permanent fund	-	-	-	-	-	-	
Capital projects funds	248,469	-	-	-	-	248,469	
Special revenue funds	2,698,914	-	-	106,526	8,563	2,814,003	
Total	<u>\$ 3,069,282</u>	<u>-</u>	<u>631,777</u>	<u>1,111,901</u>	<u>1,908,563</u>	<u>\$6,721,523</u>	

The principal purposes of interfund balances due from/to are:

- Recognize in the general fund interfund loans due from the special revenue funds amounting to \$1,729,528.
- Recognize in the head start special revenue fund the uncollected matching contributions from the general fund amounting to \$370,881.
- Recognize in the debt service fund the uncollected transfers from the general fund to cover the debt service payments of certain bonds and notes amounting to \$723,125. These debt service payments were due on July 1, 2003.
- Recognize in the nonmajor special revenue funds certain interfund loans due from the general fund amounting to \$194,052.
- Recognize certain interfund loans and transfers among nonmajor special revenue funds amounting to \$667,073.

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**8. INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS (Continuation)**

The principal purposes of interfund transfers are to:

- Make a routinary transfer of matching contributions amounting to \$631,777 from the general fund to the head start special revenue fund program.
- Make a routinary transfer of interest, amounting to \$121,899, from the debt service fund to the general fund, as permitted by law. This interest is generated by the debt service fund's deposits, which are transferred on a quarterly basis to the general fund.
- Make a routinary transfer of resources amounting to \$1,005,375 from the general fund to the debt service fund to cover debt service payments.
- Make a non-routinary transfer of resources amounting to \$1,500,000 from the debt service fund to the Eugenio María de Hostos law school fund, a nonmajor special revenue fund, as a donation to the library of such educational entity.
- Make a routinary transfer of cash surpluses amounting to \$2,569,350, which have been reassigned for unrestricted use by the general fund. The transfer was made from the surplus designation fund, a nonmajor special revenue fund, to the general fund.
- Make a non-routinary transfer of resources amounting to \$400,000 from the general fund to the surplus designation fund for the construction of the Eugenio María de Hostos Community Center.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2003.

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**9. CAPITAL ASSETS**

Capital assets activity for the year ended June 30, 2003 is as follows:

	Beginning balance, as restated (note 14)	Increases	Decreases	Reclassifications	Ending balance
<b>Governmental activities:</b>					
<b>Cost basis:</b>					
<b>Capital assets, not being depreciated/amortized:</b>					
Land	\$4,998,344	1,566,378	-	-	\$ 6,564,722
Construction in progress	2,357,143	2,794,622	-	(3,094,454)	2,057,311
Total capital assets, not being depreciated/amortized	7,355,487	4,361,000	-	(3,094,454)	8,622,033
<b>Capital assets, being depreciated/amortized:</b>					
Land improvements	4,098,380	-	-	-	4,098,380
Buildings, structures, and improvements	35,758,254	556,595	-	2,081,330	38,396,179
Infrastructure	16,736,701	-	-	1,013,124	17,749,825
Machinery and equipment under capital leases	1,867,048	256,965	-	-	2,124,013
Other machinery and equipment, and furniture and fixtures	10,346,623	187,035	(118,487)	-	10,415,171
Licensed vehicles	8,565,268	61,895	-	-	8,627,163
Total capital assets, being depreciated/amortized	77,372,274	1,062,490	(118,487)	3,094,454	81,410,731
Total cost basis of capital assets	84,727,761	5,423,490	(118,487)	-	90,032,764
<b>Less: accumulated depreciation and amortization:</b>					
Land improvements	3,435,028	390,633	-	-	3,825,661
Buildings, structures, and improvements	19,361,236	360,184	-	-	19,721,420
Infrastructure	13,432,651	691,214	-	-	14,123,865
Machinery and equipment under capital leases	814,766	461,467	-	-	1,276,233
Other machinery and equipment, and furniture and fixtures	5,329,795	1,463,872	(118,487)	-	6,675,180
Licensed vehicles	5,442,899	650,620	-	-	6,093,519
Total accumulated depreciation and amortization	47,816,375	4,017,990	(118,487)	-	51,715,878
Net capital assets	\$36,911,386	\$1,405,500	-	-	\$38,316,886

Governmental activities:  
 General government  
 Public safety  
 Economic and urban development  
 Health and sanitation  
 Public housing and welfare  
 Culture, recreation and education

At June 30, 2003 the estimated aggregate replacement cost of the Municipality's capital assets amounted to approximately \$201.5 million.

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**10. DEFERRED REVENUES**

At June 30, 2003, deferred revenues recorded in the GFFS and the GWFS are as follows:

	<u>Major Funds</u>						<u>Statement of net assets</u>
	<u>General fund</u>	<u>Debt service fund</u>	<u>State legislative joint resolutions fund</u>	<u>Head start special revenue fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>	
<i>Measurable but not available revenues:</i>							
Property taxes (note 4)	\$7,213,182	2,148,024	-	-	-	9,361,206	\$ -
Municipal licenses (note 3)	1,642,988	-	-	-	-	1,642,988	-
Rent and other charges (note 7)	1,170,823	-	-	-	-	1,170,823	-
Special item - legal claim settlement (note 17)	2,299,463	-	-	-	-	2,299,463	-
Intergovernmental grants and Contributions	204,531	-	-	-	-	204,531	-
Total measurable but unavailable revenue	12,530,987	2,148,024	-	-	-	14,679,011	-
<i>Unearned revenues:</i>							
Municipal licenses (note 3)	10,490,817	-	-	-	-	10,490,817	10,490,817
Intergovernmental grants and contributions:							
Commonwealth of Puerto Rico	-	-	8,163,918	-	-	8,163,918	8,163,918
U.S. Department of Health and Human Services	-	-	-	37,344	-	37,344	37,344
Other governmental agencies	-	-	-	-	3,084,786	3,084,786	3,084,786
Total unearned revenues	10,490,817	-	8,163,918	37,344	3,084,786	21,776,865	21,776,865
Total deferred revenues	\$23,021,804	2,148,024	8,163,918	37,344	3,084,786	36,455,876	\$21,776,865

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**11. LONG-TERM OBLIGATIONS**

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

	Balance at June 30 2002, as restated (note 14)	Borrowings or additions	Payments or deductions	Discount accretion	Balance at June 30, 2003	Balance due within one year
Bonds payable	\$ 50,279,000	-	(3,462,000)	-	46,817,000	\$3,353,000
Bond anticipation notes	5,340,420	47,975	-	-	5,388,395	-
Notes payable:						
CRIM	686,237	-	(11,394)	-	674,843	8,442
HUD	1,782,571	-	(855,436)	89,805	1,016,940	821,940
Federal Transportation Agency	224,053	-	-	-	224,053	-
Obligation under capital leases	1,221,164	256,965	(451,454)	-	1,026,675	488,471
Estimated liability for municipal solid waste landfill closure and post closure care costs	1,358,808	56,617	-	-	1,415,425	-
Compensated absences	8,733,240	-	(783,574)	-	7,949,666	3,847,328
Claims and judgments	121,294	379,492	-	-	500,786	500,786
<b>Total</b>	<b>\$ 69,746,787</b>	<b>741,049</b>	<b>(5,563,858)</b>	<b>89,805</b>	<b>65,013,783</b>	<b>\$9,019,967</b>

Historically, the general fund has been used to liquidate compensated absences, claims and judgments, federal cost disallowances, obligations under capital leases and any other long-term liabilities other than long-term debt.

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11. LONG-TERM OBLIGATIONS (Continuation)

*a) Debt Limitation*

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 by **the Municipality** 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 account of bonds or notes guaranteed by **the Municipality**, exceed 10% 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. Total property assessed value at June 30, 2003 amounted to \$528,718,491. **The Municipality's** available legal debt margin amounted to \$9,667,261.

*b) Bonds Payable*

**The Municipality** issues general obligation, special obligation and public improvement bonds to finance the acquisition, construction and improvement of capital assets, as well as, to cover certain operating needs, including the payment to suppliers.

The laws and regulations of the Commonwealth provide that public debt of **the Municipality** will constitute a first claim on the available revenue of **the Municipality**. Public debt includes bonds and notes payable. The good faith, credit and taxing power of **the Municipality** are irrevocably pledged for the prompt payment of the principal and interest of the bonds and notes payable.

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**11. LONG-TERM OBLIGATIONS (Continuation)**

*b) Bonds Payable (Continuation)*

The Municipality levies an annual additional special tax of 1.40% of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds must be set aside to redeem the bonds in minimum annual or biannual principal and interest payments. The proceeds of this special tax are recorded in the debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2003:

	<u>Outstanding balance</u>
<b><u>General municipal obligation bonds:</u></b>	
1995 serial bonds, original issue amount of \$229,000, due in annual principal installments ranging from \$6,000 to \$17,000; plus interest due in annual installments at 5.25% through January 1, 2020	\$ 202,000
1997 serial bonds, original issue amount of \$675,000, due in annual principal installments ranging from \$10,000 to \$30,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.19% at June 30, 2003) through July 1, 2021	605,000
1998 serial bonds, original issue amount of \$1,645,000, due in annual principal installments ranging from \$35,000 to \$135,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.19% at June 30, 2003) through July 1, 2016	1,420,000
2001 serial bonds, original issue amount of \$9,950,000, due in annual principal installments ranging from \$130,000 to \$805,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (4.63% at June 30, 2003) through July 1, 2026	9,820,000

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11. LONG-TERM OBLIGATIONS (Continuation)

*b) Bonds Payable* (Continuation)

	<u>Outstanding balance</u>
<b><u>General municipal obligation bonds (continued):</u></b>	
1999 serial bonds, original issue amount of \$4,055,000, due in annual principal installments ranging from \$215,000 to \$490,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (2.70% at June 30, 2003) through July 1, 2024	3,350,000
1999 serial bonds, original issue amount of \$930,000, due in annual principal installments ranging from \$10,000 to \$80,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (2.70% at June 30, 2003) through July 1, 2024	890,000
1999 serial bonds, original issue amount of \$205,000, due in annual principal installments ranging from \$5,000 to \$15,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (2.70% at June 30, 2003) through July 1, 2024	190,000
1999 serial bonds, original issue amount of \$1,105,000, due in annual principal installments ranging from \$170,000 to \$445,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (2.70% at June 30, 2003) through July 1, 2013	615,000
1999 serial bonds, original issue amount of \$4,060,000, due in annual principal installments ranging from \$150,000 to \$220,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (2.70% at June 30, 2003) through July 1, 2005	3,505,000
1999 serial bonds, original issue amount of \$1,310,000, due in annual principal installments ranging from \$20,000 to \$110,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (2.70% at June 30, 2003) through July 1, 2024	1,250,000

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11. LONG-TERM OBLIGATIONS (Continuation)

*b) Bonds Payable* (Continuation)

	<u>Outstanding balance</u>
1997 serial bonds, original issue amount of \$4,565,000, due in annual principal installments ranging from \$240,000 to \$565,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.19% at June 30, 2003) through July 1, 2008	2,800,000
2002 serial bonds, original issue amount of \$3,525,000, due in annual principal installments ranging from \$145,000 to \$395,000; plus interest due in semiannually installments at variable rates not to exceed 8.00% (5.19% at June 30, 2003) through July 1, 2012	<u>2,870,000</u>
Total general municipal obligation bonds	<u>27,517,000</u>
<b><u>Special municipal obligation bonds:</u></b>	
1996 serial bonds, original issue amount of \$400,000, due in annual principal installments ranging from \$10,000 to \$40,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.00% at June 30, 2003) through July 1, 2016	330,000
1997 serial bonds, original issue amount of \$7,510,000, due in annual principal installments ranging from \$165,000 to \$715,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.00% at June 30, 2003) through July 1, 2017	6,550,000
2000 serial bonds, original issue amount of \$2,865,000, due in annual principal installments ranging from \$200,000 to \$390,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.00% at June 30, 2003) through July 1, 2010	<u>2,445,000</u>
Total special municipal obligation bonds	<u>9,325,000</u>

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11. LONG-TERM OBLIGATIONS (Continuation)

*b) Bonds Payable* (Continuation)

	<u>Outstanding balance</u>
<b><u>Public improvement bonds:</u></b>	
1996 serial bonds, original issue amount of \$1,025,000, due in annual principal installments ranging from \$35,000 to \$110,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.70% at June 30, 2003) through July 1, 2010	690,000
1994 serial bonds, original issue amount of \$9,950,000, due in annual principal installments ranging from \$405,000 to \$1,120,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (7.11% at June 30, 2003) through July 1, 2008	5,580,000
1994 serial bonds, original issue amount of \$9,950,000, due in annual principal installments ranging from \$405,000 to \$1,120,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (7.11% at June 30, 2003) through July 1, 2008	5,580,000
1988 serial bonds, original issue amount of \$6,000,000, due in annual principal installments ranging from \$100,000 to \$480,000; plus interest due in semiannual installments at 8.20% through July 1, 2007	2,675,000
1994 serial bonds, original issue amount of \$1,170,000, due in annual principal installments ranging from \$15,000 to \$55,000; plus interest due in semiannual installments at variable rates not to exceed 8.00% (5.70% at June 30, 2003) through July 1, 2019	<u>1,030,000</u>
Total public improvements bonds	<u>9,975,000</u>
Total bonds payable	<u>\$ 46,817,000</u>

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**11. LONG-TERM OBLIGATIONS (Continuation)**

*b) Bonds Payable (Continuation)*

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

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

<b>Year ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2004	\$ 3,353,000	2,686,395	\$ 6,039,395
2005	3,608,000	2,604,876	6,212,876
2006	3,904,000	2,379,484	6,283,484
2007	3,979,000	2,135,525	6,114,525
2008	4,309,000	1,870,173	6,179,173
2009-2013	13,220,000	6,393,912	19,613,912
2014-2018	7,271,000	3,487,943	10,758,943
2019-2023	3,873,000	1,676,973	5,549,973
2024-2028	3,300,000	425,490	3,725,490
Totals	<u>\$46,817,000</u>	<u>23,660,771</u>	<u>\$70,477,771</u>

At June 30, 2003, accrued interest payable on bonds amounted to \$1,330,026.

*c) Bond Anticipation Notes*

Advances on bond anticipation notes (BAN's) with the U.S. Department of Rural Development (USDRD) have been recorded within long-term obligations in the accompanying statement of net assets. During the fiscal year ended June 30, 2003, the proceeds received from BAN's amounted to \$47,975, which have been recorded as other financing sources in the capital projects fund, and as an increase in the BAN's liability in the statement of net assets. The proceeds of BAN's have been used to finance construction projects of **the Municipality**.

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11. LONG-TERM OBLIGATIONS (Continuation)

*c) Bond Anticipation Notes (Continuation)*

**The Municipality** has taken all the legal steps, and has the ability, to refinance such BAN's on a long-term basis with GDB. The agreement with GDB permits that, after all approved advances under the financing agreement with USDRD are received by **the Municipality**, the BAN's be refinanced on a long-term basis. The agreement with GDB is noncancelable and does not expire within one year after June 30, 2003. The obligations under the agreement are not callable during that period, except for violations of the provisions of the agreement, for which compliance is objectively determinable or measurable. At June 30, 2003, no violations of the agreement exist, and no available information indicates that a violation has occurred thereafter prior to the issuance of the accompanying financial statements. At June 30, 2003, the outstanding balance of the advances received and the related unused amounts under the financing agreement with USDRD amounted to \$5,388,395 (including capitalized accrued interest at a rate of 5%) and \$1,321,605, respectively.

According to the agreement with GDB, **the Municipality** will refinance, on a long-term basis, the aforementioned BAN's through the issuance of three individual series of bonds denominated as general municipal obligation bonds with original issue amounts of \$3,300,000, \$1,910,000 and \$1,510,000. These bond series will bear interest at variable rates to be determined by and agreed with GDB prior to the issuance of the bonds.

*d) Notes Payable to CRIM*

Law No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows for the financing of a debt that the municipalities of Puerto Rico have with CRIM, arising from the final settlements of property tax advances versus actual collections through fiscal year 2000. The amounts that the Municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth to the municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238 of August 15, 1999.

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**11. LONG-TERM OBLIGATIONS (Continuation)**

*d) Notes Payable to CRIM*

In addition, on December 16, 2002 **the Municipality** entered into a repayment agreement with GDB and CRIM to pay off the remaining \$686,237 of excess of property tax advances from fiscal years 2000 and 2001. CRIM retains the principal and interest from the property tax advances of **the Municipality**. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB (6.48% at June 30, 2003) but not exceeding 8%. The outstanding principal and accrued interest balances of the note payable to CRIM amounted to \$674,843 and \$3,452, respectively, at June 30, 2003. The principal and interest maturities are as follows:

<b>Year ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2004	\$ 8,442	42,261	\$ 50,703
2005	8,990	41,713	50,703
2006	9,573	41,130	50,703
2007	10,193	40,510	50,703
2008	10,854	39,849	50,703
2009-2013	65,786	187,732	253,518
2014-2018	90,060	163,458	253,518
2019-2023	123,290	130,228	253,518
2024-2028	168,784	84,734	253,518
2029-2033	178,871	23,942	202,813
Totals	<u>\$ 674,843</u>	<u>795,557</u>	<u>\$ 1,470,400</u>

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11. LONG-TERM OBLIGATIONS (Continuation)

*e) Notes Payable to HUD*

**Loan guarantee commitment** – The Municipality has a loan guarantee commitment of \$850,000 with HUD, pursuant to an application under Section 108 of the Housing and Community Development Act of 1974. Section 108 commitments made are required to be supported by a credit subsidy appropriation pursuant to the Federal Credit Reform Act of 1990 (Credit Reform Act) and implementing guidance issued by the U.S. Office of Management and Budget. Therefore, in connection with its guarantee of the notes, HUD obligated appropriated funds to cover the credit subsidy cost of the loan guarantee, as required under the Credit Reform Act. Under the Credit Reform Act procedures, such funds are disbursed into a financing account, as loan proceeds are disbursed by the lender (a local commercial bank). The financing account is in some respects equivalent to an internal loss reserve for the federal government. Each disbursement into the financing account is equal to the loan advance times the credit subsidy rate, which is part of HUD's budget approved by OMB and the Congress.

Pursuant to the credit subsidy implementation guidance issued by OMB, the undisbursed balance of the credit subsidy obligation must be canceled on September 30<sup>th</sup> of the 5<sup>th</sup> fiscal year after the period of availability for obligation of a fixed appropriation account ends.

The proceeds of the loan guarantee commitment are used for allowable construction activities approved by HUD and bear interest at various rates ranging from of 6.53% to 6.67%. The loan guarantee commitment is repaid with funds of the Community Development Block Grant (CDBG) program. At June 30, 2003, the outstanding principal and accrued interest balances of the loan guarantee commitment amounted to \$285,000 and \$7,829, respectively. The loan guarantee commitment is subject to various positive, negative and restrictive covenants that **the Municipality** has complied with at June 30, 2003.

The principal and interest maturities on the Section 108 loan guarantee commitment are as follows:

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11. LONG-TERM OBLIGATIONS (Continuation)

*e) Notes Payable to HUD (Continuation)*

Year ending June 30,	Principal	Interest	Total
2004	\$ 90,000	15,850	\$105,850
2005	95,000	9,791	104,791
2006	100,000	3,335	103,335
Totals	<u>\$285,000</u>	<u>28,976</u>	<u>\$313,976</u>

**Federal cost disallowances** – On July 1, 1997 the HUD Office of Inspector General (OIG) issued an audit report for the operation of the Community Development Block Grant (CDBG) and the Section 108 Loan Guarantee programs administered by **the Municipality**. The audit covered program years 1986 and 1987. Such report shows \$4,724,934 of ineligible costs and \$2,224,877 of unsupported costs. In 1998, HUD cleared the amount of \$1,755,825 based on response and evidence submitted by **the Municipality**, sustained \$4,435,594 as ineligible and unsupported costs, and suspended \$3,335,908 until litigation with a subgrantee is finally resolved by court. On October 23, 1999, a payment of \$1,251,906 was made by **the Municipality** to HUD to reduce such debt. Also, a letter from the OIG dated June 19, 2000 informed **the Municipality** that the outstanding balance of \$3,081,742 should be reimbursed in eight (8) non-interest bearing biannual payments of \$385,218 each through May 1, 2004. This note payable has an imputed interest rate of 7.54%. The outstanding balance of this note, net of the unamortized discount of \$38,495, amounted to \$731,940, at June 30, 2003. Accrued interest payable amounted to \$9,002 at June 30, 2003. Amortization of the note discount for the year ended June 30, 2003 amounted to \$89,805, which has been recorded as interest expense in the accompanying statement of activities.

*f) Notes Payable to Federal Transportation Agency*

**The Municipality** has a loan commitment with the Federal Transportation Agency (FTA) amounting to \$830,000. The proceeds of the loan guarantee are used for allowable construction activities approved by FTA and bear interest at a rate of 5%. CRIM retains the principal and interest amounts from the property tax advances of **the Municipality**. The amounts retained by CRIM are remitted to FTA. At June 30, 2003, the outstanding principal and accrued interest balances of the loan commitment with FTA amounted to \$224,053 and \$1,307, respectively.

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**11. LONG-TERM OBLIGATIONS (Continuation)**

*f) Notes Payable to Federal Transportation Agency (Continuation)*

The principal and interest maturities on the FTA loan commitment are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ -	1,961	\$ 1,961
2005	224,053	-	224,053
Totals	<u>\$ 224,053</u>	<u>1,961</u>	<u>\$ 226,014</u>

*g) Lease Obligations*

The Municipality leases building and office facilities under operating lease agreements with third parties. These lease agreements contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. Management has concluded that the likelihood of invoking the cancellation provisions is remote, therefore, the remaining terms of these leases will extend beyond one year. Total costs for such leases were approximately \$517,000 for the year ended June 30, 2003. The future minimum lease payments for these leases are as follows:

<u>Year ending June 30,</u>	<u>Amount</u>
2004	\$ 517,000
2005	546,076
2006	547,740
2007	547,740
2008	547,740
2009-2013	2,738,700
2014-2018	2,738,700
2019-2023	2,738,700
2024-2028	2,738,700
2029-2033	2,738,700
Total future minimum lease payments	<u>\$ 15,431,728</u>

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11. LONG-TERM OBLIGATIONS (Continuation)

*g) Lease Obligations (Continuation)*

The Municipality is obligated under capital leases with third parties that expire through 2006 for the acquisition of machinery and equipment. At June 30, 2003, the capitalized costs and the related accumulated amortization of the leased machinery and equipment amounted to \$2,124,013 and \$1,276,233, respectively, which are accounted for as capital assets in the accompanying government-wide statement of net assets. Amortization charges applicable to capital leases and included within depreciation expense amounted to \$20,048. The present value of the future minimum capital lease payments at June 30, 2003 reported in the accompanying government-wide statement of net assets is as follows:

<u>Year ending</u> <u>June 30,</u>	<u>Amount</u>
2004	\$ 547,951
2005	439,846
2006	129,928
Total future minimum lease payments	1,117,725
Less: amount representing future interest cost at rates ranging between 5.43% and 7.73%	91,050
Present value of minimum lease payments	1,026,675
Less:	
Current portion of obligation under capital leases	488,471
Obligation under capital leases, excluding current portion	\$ 538,204

*h) Municipal Solid Waste Landfill Closure and Post closure Care Costs*

According to the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991, the Municipality is required to place a final cover on the Municipality's landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with GASB No. 18, the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality has recognized a liability of \$1,415,425 in the

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11. LONG-TERM OBLIGATIONS (Continuation)

*h) Municipal Solid Waste Landfill Closure and Post closure Care Costs (Continuation)*

accompanying GWFS using current costs allocated based on the actual landfill capacity used at June 30, 2003. The portion of the estimated current costs to be incurred in future years is approximately \$339,702, which has not been recorded yet in the accompanying GWFS. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2003, **the Municipality's** landfill is still operating and its remaining estimated useful life is approximately 6 years. Approximately 81 percent of **the Municipality's** total capacity has been used at June 30, 2003.

*i) Compensated Absences*

At June 30, 2003, the liability for compensated absences is composed as follows:

	Due within one year	Due after one year	Total
Vacation	\$1,991,295	1,193,901	\$3,185,196
Sick leave	1,219,451	2,908,437	4,127,888
Compensatory time	636,582	-	636,582
Total	<u>\$3,847,328</u>	<u>4,102,338</u>	<u>\$7,949,666</u>

12. EMPLOYEES' RETIREMENT SYSTEMS

*a) Plan Description*

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

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**12. EMPLOYEES' RETIREMENT SYSTEMS (Continuation)**

*a) Plan Description (Continuation)*

The System is independent, thus assets may not be transferred to another system or used for any other purpose other than to benefit each of the System's participants. The System issues publicly available financial reports that include its basic financial statements and required supplementary information, 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 vest 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% 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 program ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the System as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons employed on or after January 1, 2000, are only allowed 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 are invested by the System, together with those of the current defined benefit plan.

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**12. EMPLOYEES' RETIREMENT SYSTEMS** (Continuation)

*a) Plan Description* (Continuation)

Benefits at retirement are not guaranteed by the Commonwealth nor **the Municipality**. The annuity is based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the participant' salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note, (2) earn a rate equal to 75% of the return of ERS'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% of the participant' salary) will be used to fund the current plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the plan on or after January 1, 2000.

On August 12, 2000, Act No. 174 was approved to allow certain participants of 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 are receiving monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation which was computed based on the highest 36 months of compensation recognized by ERS. In these cases, **the Municipality** was responsible for contributing to ERS amounts to cover the benefit payments and the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

Historically, the Commonwealth has reported ERS and System 2000 in its basic financial statements. Accordingly, the Commonwealth is currently assuming 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 at the rates detailed below.

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**12. EMPLOYEES' RETIREMENT SYSTEMS (Continuation)**

*b) Funding Policy (Continuation)*

Contribution requirements are established by law and are as follows:

Municipality and other employers	9.275% of applicable payroll
Employees:	
Hired on or before March 31, 1990	5.775% of monthly gross salary up to \$550
Hired on or before April 1, 1990	8.275% of monthly gross salary up to \$550
Hired on or before April 1, 1990	8.275% of monthly gross salary

*c) Annual Pension Cost and Net Pension Obligation*

The net pension obligation and the annual pension cost of ERS and System 2000 as of and for the year ended June 30, 2002 (most recent data available), which includes the employees of **the Municipality**, the Commonwealth and other municipalities, have been recorded in the basic financial statements of the Commonwealth. No allocation of such amounts has been made in the accompanying basic financial statements. The following aggregate annual pension cost and net pension obligation as of and for the year ended June 30, 2002 (most recent data available) which are assumed and accounted for by the Commonwealth, is presented only for the purposes of additional analysis (amounts expressed in thousands):

Annual required contributions	\$ 802,536
Interest on net pension obligation	192,416
Adjustment to annual required employers' contributions	(134,870)
Annual pension cost	<u>860,082</u>
Statutory employers' contributions made	(308,228)
Increase (decrease) in net pension obligation	551,854
Net pension obligation at beginning of year	<u>2,263,722</u>
Net pension obligation at end of year	<u>\$ 2,815,576</u>

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**12. EMPLOYEES' RETIREMENT SYSTEMS (Continuation)**

*b) Funding Policy (Continuation)*

The annual required contribution recorded at June 30, 2002 (most recent data available) in the basic financial statements of the Commonwealth was determined by actuarial valuations for the pension plans as described below:

Date of latest actuarial valuation:	June 30, 2001
Actuarial cost method:	Projected unit credit cost
Amortization cost method:	Level percentage of projected payroll
Remaining amortization period:	25 years
Amortization approach:	Closed
Asset valuation method:	Market Value
Actuarial assumptions:	
Inflation	3.50%
Investment rate of return	8.50%
Projected salary increases per annum	5.00%
Cost-of-living adjustments	3.0% every three years

*c) Three-Year Trend Information*

The three-year trend information is as follows (most recent data available; expressed in thousands):

<b>Annual pension cost (APC):</b>	
Year ended June 30, 2002	\$ 860,082
Year ended June 30, 2001	803,526
Year ended June 30, 2000	768,761
<b>Percentage of APC contributed:</b>	
Year ended June 30, 2002	35.8%
Year ended June 30, 2001	65.6%
Year ended June 30, 2000	35.8%
<b>Net pension obligation:</b>	
Year ended June 30, 2002	\$ 2,815,576
Year ended June 30, 2001	2,263,722
Year ended June 30, 2000	2,010,051

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12. EMPLOYEES' RETIREMENT SYSTEMS (Continuation)

c) *Three-Year Trend Information* (Continuation)

Contributions made by **the Municipality** and its participating employees to ERS and System 2000 were as follows during the last three fiscal years:

Fiscal year ended June 30,	Employer contributions	Employee contributions
2001	\$1,167,400	\$971,000
2002	\$1,284,889	\$993,310
2003	\$1,210,161	\$1,019,387

13. COMMITMENTS AND CONTINGENCIES

a) *Commitments*

**The Municipality** has several outstanding or planned non-cancelable construction projects amounting to \$4,258,608 at June 30, 2003, of which \$2,057,311 have been incurred and paid, and \$2,201,297 remain outstanding to incur through the end of each project. These projects are evidenced by contractual commitments with contractors and are accounted for in the capital projects funds.

As more fully described in note 11, **the Municipality** has an outstanding loan commitment with FTA amounting to \$830,000 to be used for allowable construction activities. The unused portion of this loan guarantee commitment amounted to \$605,947 at June 30, 2003. In addition, **the Municipality** has an outstanding loan guarantee commitment of \$850,000 with HUD, pursuant to an application under Section 108 of the Housing and Community Development Act of 1974. The unused portion of this loan guarantee commitment amounted to \$565,000 at June 30, 2003.

**The Municipality** has reported, outstanding encumbrances amounting to \$1,643,357 in the general fund at June 30, 2003. **The Municipality** intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

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13. COMMITMENTS AND CONTINGENCIES (Continuation)

*a) Commitments* (Continuation)

At June 30, 2003, **the Municipality's** public assistance grant fund and the community block grant fund, two non major special revenue funds, reported fund deficits amounting to \$998,758 and \$156, respectively. It is the intention of **the Municipality** to cover such deficits through future budgetary appropriations of the general fund. However, no resources have been provided by the general fund for such purposes at June 30, 2003.

*b) Contingencies*

**The Municipality** is defendant in various claims and legal proceedings pertaining to matters incidental to the performance of routine governmental operations amounting to approximately \$40.7 million. Under Act No. 104 of June 25, 1995, as amended, persons are authorized to sue **the Municipality** only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, **the Municipality** may provide its officers and employees with legal representation, as well as assume the payment for any judgment that may be entered against them. However, there is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, **the Municipality** has reported liabilities amounting to \$500,786 for awarded and anticipated unfavorable judgments at June 30, 2003. This amount was included as a long-term liability in the accompanying government-wide statement of net assets, and represents the amount estimated as a probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment. It is management's opinion, based on the advice of its legal counsel, that the potential claims against **the Municipality** not covered by insurance will not materially affect the financial condition nor the results of operations of **the Municipality**. In addition, management believes that the ultimate liability in excess of amounts recorded in the accompanying government-wide statement of net assets, if any, would not be material to the basic financial statements taken as a whole.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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**13. COMMITMENTS AND CONTINGENCIES (Continuation)**

*b) Contingencies (Continuation)*

**The Municipality** receives financial assistance from the federal government of the United States of America in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. Disallowance as a result of these audits may become liabilities of **the Municipality**. The *“Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of OMB Circular A-133”* for the year ended June 30, 2003, disclosed various instances of noncompliance with applicable laws and regulations and with internal accounting and administrative controls. If expenditures are disallowed due to noncompliance with grant programs regulations, **the Municipality** may be required to reimburse the grantor. Management believes that **the Municipality** will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, consequently, the accompanying basic financial statements do not include any provision or reserve for possible disallowed costs arising from the federal funds disbursed during fiscal year ended June 2003.

In December 2001, CRIM refinanced approximately \$70 millions of its long-term debt with a financial institution related with the Land Information Management System (LIMS) project. The loan bears interest at 5.95% for a ten-year period ending in 2011. The loan is collateralized proportionally with the ad valorem personal and real property of all municipalities of the Commonwealth.

**14. ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS**

During the current year, **the Municipality** implemented new accounting standards issued by GASB. GASB No. 34, as amended by GASB No. 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 GWFS, **the Municipality** is required to present GWFS, prepared 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 prior financial statement balances were required.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003**

**14. ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS (Continuation)**

These new standards caused most of the accounting changes, changes in reporting entity, and restatements described on the ensuing discussion 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 balance as previously reported by **the Municipality** to the beginning fund balance, as restated:

	June 30, 2002 fund balance, as previously reported	Fund reclassification s	Correction of accounting errors and other adjustment s	June 30, 2002 fund balance, as restated
<i>Major funds:</i>				
General fund	\$ 8,111,706	(179,227)	195,370	\$ 8,127,849
Major special revenue funds:				
State legislative joint resolutions				
special revenue fund	2,680,206	-	(2,680,206)	-
Debt service fund	11,298,797	-	243,993	11,542,790
	<u>22,090,709</u>	<u>(179,227)</u>	<u>(2,240,843)</u>	<u>19,670,639</u>
<i>Other governmental funds:</i>				
Capital projects fund	9,022,182	-	-	9,022,182
Nonmajor special revenue fund – State salary incentive fund	1,362,764	179,227	4,056,444	5,598,435
Permanent fund – Mayagüez economic development fund	-	1,178,226	(185,774)	992,452
Expendable trust fund	1,178,226	(1,178,226)	-	-
	<u>11,563,172</u>	<u>179,227</u>	<u>3,870,670</u>	<u>15,613,069</u>
Total governmental funds	<u>\$ 33,653,881</u>	<u>-</u>	<u>1,629,827</u>	<u>\$ 35,283,708</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF MAYAGUEZ**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2003**

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**14. ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS (Continuation)**

Upon the adoption of GASB No. 34, **the Municipality** revised the classifications of its governmental funds, which resulted in reclassifications of the Mayagüez economic development fund and the state salary incentive fund, in accordance with GAAP. These fund reclassifications consist of the following:

- The state salary incentives fund, which was reported in previous years as part of the general fund, was reclassified as part of the non major special revenue funds since it accounts for grants received by the Department of Labor and Human Resources of the Commonwealth, which are restricted for salary subsidies.
- The Mayagüez economic development fund, was reported in previous years as a nonexpendable trust fund, therefore, was reclassified as a non major permanent fund, since according to GASB No. 34, resources held in trust to support **the Municipality's** own programs should be accounted for in permanent funds.

Upon the adoption of GASB No. 34, **the Municipality** corrected certain accounting errors reported in the prior year's governmental funds. These errors consist principally in the effect of not adopting the provisions of GASB No. 33 prior to June 30, 2002, as required by GAAP. Accounting errors corrected in the general fund include the correction of an understatement in cash balances of the general fund amounting to approximately \$2.1 million.

In addition, certain prior-period adjustments were recorded at July 1, 2002 to eliminate from the governmental funds certain liabilities previously accounted for, as fund liabilities, which are now considered liabilities in the GWFS only, according to the provisions of GASBI No. 6 and the accrual basis of accounting.

The following schedule reconciles the balances previously reported in the general fixed assets account group (GFAAG), the general long-term debt account group and the component unit at June 30, 2002. The assets and liabilities previously reported in the GFAAG and the GLTDAG, respectively, are reported in the accompanying GWFS since GASB No.34 eliminated such account groups.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003**

**14. ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND  
RESTATEMENTS (Continuation)**

<i>Account groups:</i>	June 30, 2002, balances, as previously reported	Change in reporting entity	Change in basis of accounting	Correction of accounting errors and other adjustments	June 30, 2002, balances, as restated
General fixed assets account group (unaudited)/capital assets, net	\$81,217,897	-	(44,306,511)	-	\$ 36,911,386
General long-term debt account group:					
Employees' christmas bonus	-	-	-	687,057	687,057
Compensated absences	5,928,319	-	-	2,804,921	8,733,240
Legal claims and judgments	2,365,000	-	-	(2,243,706)	121,294
Solid waste landfill closure and post closure care costs	2,706,000	-	-	(1,347,192)	1,358,808
Bonds and notes payable	47,194,000	-	-	4,365,290	51,559,290
Bond anticipation notes	5,340,420	-	-	-	5,340,420
Federal cost disallowances	1,540,870	-	-	(128,299)	1,412,571
Obligation under capital leases	688,362	-	-	532,802	1,221,164
	<u>\$ 65,762,971</u>	<u>-</u>	<u>-</u>	<u>4,670,873</u>	<u>\$ 70,433,844</u>
<i>Component unit:</i>					
Mayagüez-Las Marías Consortium	\$ 453,679	(453,679)	-	-	\$ -

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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**14. ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS (Continuation)**

The cost basis of capital assets of **the Municipality** has been adjusted (increased) in the amount of \$3,509,864 as of the beginning of the year as part of the adoption of GASB No. 34 to: (1) recognize infrastructure assets, (2) recognize changes in capitalization thresholds, (3) record capital assets previously not accounted for and (4) to eliminate nonexisting and impaired capital assets. These adjustments were the result of a physical inventory taking of capital assets across all **the Municipality's** departments and a reevaluation of the legal title of such assets. The capital assets were also adjusted (decreased) as of the beginning of the year in the amount of \$47,816,375 to record the accumulated depreciation and amortization as part of the adoption of GASB No. 34. The net adjustment decrease of capital assets as a result of the adoption of GASB No. 34 amounted to \$44,306,511.

**The Municipality's** general-purpose financial statements as of and for the year ended June 30, 2002 reported the *Mayagüez – Las Marías Consortium* (the Consortium) as a discretely presented component unit of **the Municipality**. The Consortium is a legally separate entity organized on December 1993 through an agreement between **the Municipality** and **the Municipality** of Las Marías in order to receive and administer funds in accordance with the Workforce Investment Act of 1998. During the current year, **the Municipality's** management revised the criteria set forth by GASB No. 14, as applicable to the accompanying basic financial statements, and determined that such entity did not meet the criteria established by GAAP to consider it as a component unit of **the Municipality**. The effect of the prior-period adjustment related to this matter has been presented in the "change in reporting entity" column on the above schedule.

Correction of accounting errors and other adjustments in the long-term liabilities reported in the prior year's general long-term debt account group were related to unrecorded liabilities and overstatements in certain other liabilities at June 30, 2002.

**15. SUBSEQUENT EVENTS**

On October 17, 2003 the Municipal Legislature approved the issuance of municipal general obligation bonds amounting to \$2,845,000. The proceeds of these bonds will be used for the acquisition of equipment. These serial bonds are dated July 1, 2003 and are due in annual principal installments ranging from \$515,000 to \$625,000, plus interest (at variable rates) due in biannual installments, through July 1, 2008.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003

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**15. SUBSEQUENT EVENTS (Continuation)**

On October 23, 2003 the Municipal Legislature approved the issuance of municipal general obligation bonds amounting to \$7,945,000. The proceeds of these bonds will be used for: (1) construction and major capital improvements and (2) the payment to suppliers. These serial bonds are dated July 1, 2003 and are due in annual principal installments ranging from \$165,000 to \$540,000, plus interest (at variable rates) due in biannual installments, through July 1, 2028.

On October 23, 2003 the Municipal Legislature approved the issuance of municipal general obligation bonds amounting to \$3,510,000. The proceeds of these bonds will be used for the acquisition of real property. These serial bonds are dated July 1, 2003 and are due in annual principal installments ranging from \$75,000 to \$235,000, plus interest (at variable rates) due in biannual installments, through July 1, 2028.

On December 18, 2003 the Puerto Rico Ports Authority, a component unit of the Commonwealth, transferred to **the Municipality**, at no cost, all of the ports facilities located in Mayagüez. The fair market value of the property transferred has not been determined at June 30, 2003.

**16. SPECIAL ITEM**

In December 2000, **the Municipality** and other municipalities of Puerto Rico filed a complaint against the Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth, in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenged the application by PREPA of the "net revenue" formula, which reduced the amount available to pay contributions in lieu of taxes, and energy sales set aside for **the Municipality**. On March 18, 2003, the Board of Directors of PREPA approved a resolution by which PREPA agreed to settle the claims with all municipalities. Accordingly, PREPA offered to pay \$125 million to all municipalities to settle the claim, which are divided in \$68 million in cash and \$57 million in the construction of electric infrastructure projects on behalf of the municipalities. Of such amounts, **the Municipality** will receive \$2,299,463 in cash and \$1,927,956 in future construction projects. At June 30, 2003, an intergovernmental receivable from PREPA amounting to \$2,299,463 has been recorded in the general fund and the government-wide statement of net assets to recognize the settlement to be collected by **the Municipality** from PREPA. This transaction falls under the definition of special item set forth by GASB No. 34, as it is a transaction of unusual and infrequent nature within the control of **the Municipality's** management. Accordingly, the accompanying statement of activities includes a special item of \$1,839,570 recorded in

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGUEZ  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2003**

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**16. SPECIAL ITEM (Continuation)**

the government-wide statement of activities, which represents the net benefit to be collected from PREPA, after deducting professional fees amounting to \$459,893 (recorded within accounts payable in the government-wide statement of net assets) to be paid to **the Municipality's** legal counselors. In the accompanying governmental funds' balance sheet, deferred revenue of \$2,299,463 has been recorded at June 30, 2003 since the receivable from PREPA is not considered a current available financing resource at June 30, 2003.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

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**ADDITIONAL REPORTS REQUIRED UNDER THE OMB CIRCULAR A-133**

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## **NIEVES VELAZQUEZ & CO., P.S.C.**

**Certified Public Accountants and Financial Consultants**

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

Mayor and Municipality Council  
Municipality of Mayagüez  
Mayagüez, Puerto Rico

We have audited the basic financial statements of **the Municipality of Mayagüez of the Commonwealth of Puerto Rico (The Municipality)** as of and for the year ended June 30, 2003, and have issued our unqualified report thereon dated January 15, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

#### Compliance

As part of obtaining reasonable assurance about whether **the Municipality's** basic financial statements are free of material misstatement, we performed test 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 statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards. This noncompliance instance is described in the accompanying Schedule of Findings and Questioned Costs as Item 03-II-1.

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered **the Municipality's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect **the Municipality's** ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings and Questioned Costs, as Item 03-II-1.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable condition described above, we consider Item 03-II-1 to be a material weakness.

This report is intended for the information of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

January 15, 2004  
San Juan, Puerto Rico

CPA Stamp 1882080 was affixed  
to the record copy of this report.

*Nieves Velázquez & Co., P.S.C.*





## **NIEVES VELAZQUEZ & CO., P.S.C.**

**Certified Public Accountants and Financial Consultants**

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

Mayor and Municipality Council  
Municipality of Mayagüez  
Mayagüez, Puerto Rico

#### Compliance

We have audited the compliance of **the Municipality of Mayagüez of the Commonwealth of Puerto Rico (The Municipality)** 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's** major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of **the Municipality's** management. Our responsibility is to express an opinion on **the Municipality's** compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about **the Municipality's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on **the Municipality's** compliance with those requirements.

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

Compliance (Continuation)

In our opinion, **the Municipality** 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. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Finding and Questioned Costs as Items 03-III-1 and 03-III-2.

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect **the Municipality's** ability to administer a major federal program in accordance with the applicable requirements of laws regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 03-III-1 and 03-III-2.

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

Internal Control Over Compliance (Continuation)

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of **the Municipality** as of and for the year ended June 30, 2003, and have issued our unqualified report thereon dated January 15, 2004. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements of **the Municipality**. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended for the information of the audit committee, management and federal awarding agencies and pass-through entities and it is not intended to be and should not be used by anyone other than these specified parties.

February 16, 2004  
San Juan, Puerto Rico

CPA Stamp #1882081 was affixed  
to the record copy of this report.

*Nieves Velazquez & Co., P.S.C.*



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2003**

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (Note 2)	Pass-Through Entity Identifying Federal Number (Note 3)	Expenditures (Notes 1 and 4)
<u>U.S. Department of HUD</u>			
Major Programs:			
Direct Programs:			
Section 8 Housing Choice Vouchers	14.871	N/A	\$ 3,750,845
Non-Major Programs:			
Direct Programs:			
Community Development			
Block Grant-Entitlement (CDBG)	14.218	N/A	3,404,984
Home Investment Partnership Prog.	14.239	N/A	503,967
Lower Income Housing Assistance Prog.			
Rental Housing Rehabilitation	14.230	N/A	203,962
Emergency Shelter Grants	14.231	N/A	114,309
<u>U.S. Department of Health and Human Services</u>			
Major Program:			
Direct Program:			
Head Start	93.600	N/A	7,750,973
Non-Major Program:			
Passed through the P.R. Governor Office:			
Special Programs for the Aging			
Title III-B	93.044	N/A	<u>277,327</u>
Sub-Total Carryforward			<u>16,006,367</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2003**

Federal Grantor/Pass-Through Grantor /Program Title <hr/>	Federal CFDA Number (Note 2) <hr/>	Pass-Through Entity Identifying Federal Number (Note 3) <hr/>	Expenditures  (Notes 1 and 4)
Balance brought-forward			\$16,006,367
 <u>U.S. Department of Commerce</u>			
Non-Major Program:			
Passed-through Puerto Rico			
Transportation Federal Transit			
Capital Improvement Grants	20.500	PR 89-29-0616-526-F	52,495
 <u>U.S. Department of Agriculture</u>			
Non-Major Programs:			
Passed through the P.R. Department			
of Education:			
Child and Adult Care Food Prog.	10.558	CCC-051	616,371
Direct Program:			
Community Facilities Loans and			
Grants	10.766	N/A	96
 <u>U. S. Federal Emergency Management Agency</u>			
Major Program:			
Passed through Puerto Rico Governor's			
Authorized Representative (GAR):			
Public Assistance Grants	83.544	N/A	<u>712,527</u>
Total Federal Awards Expenditures			<u>\$17,387,856</u>

See notes to the Schedule of Federal Financial Awards.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2003**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Government and Nonprofit Organizations.

**2. FEDERAL CFDA NUMBER**

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

**3. PASS-THROUGH ENTITY IDENTIFYING**

State or local government redistributions of federal awards to the Municipality, known as "pass-through awards", should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for federal awards received as a sub recipient. Number identified as N/A are not applicable or not available.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2003**

**4. RECONCILING OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE GENERAL PURPOSE FINANCIAL STATEMENTS**

Amounts included in the accompanying schedule agree with the amounts included in the basic financial statements as follows:

<u>Fund</u>	<u>Federal Assistance</u>	<u>Other Assistance</u>	<u>Financial Statements</u>
Head Start	\$ 7,750,973	2,585,298	10,336,271
Other Governmental Funds	<u>9,636,883</u>	<u>6,499,164</u>	<u>16,136,047</u>
	<u>\$17,387,856</u>	<u>9,084,462</u>	<u>26,472,318</u>

The other Governmental Funds includes \$3,062,472 of transfer out.

**5. FEMA-PUBLIC ASSISTANCE GRANTS**

During the fiscal year 2003, the Federal Emergency Management Agency approved \$337,669 additional funding related principally with Huracan Georges expenditures incurred in prior years.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

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

**Section I. Summary of Audit Results**

**Part I. Financial Statements**

- |    |   |   |                             |
|----|---|---|-----------------------------|
| 1. | Type of audit report: <b>Unqualified opinion</b>      |   |                             |
| 2. | Reportable conditions reported:                       | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 3. | Reportable conditions reported as material weaknesses | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 4. | Material noncompliance disclosed                      | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |

**Part II. Federal Awards**

- |    |   |   |  |
|----|---|---|--|
| 1. | Reportable conditions reported:   | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            |
| 2. | Reportable conditions reported as material weaknesses                         | <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No |
| 3. | Type of report on compliance for major programs <b>Unqualified opinion</b>    |   |  |
| 4. | Audit findings required to be reported under Section 510(a) of Circular A-133 | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            |
| 5. | Identification of major programs:   |   |  |

Name of Federal Program or Cluster

CFDA Number (s)

Head Start	93.600
Section 8 Housing Choice Vouchers	14.871
Public Assistance Grants	83.544

- |    |   |   |                             |
|----|---|---|-----------------------------|
| 6. | Dollar threshold used to distinguish between Type A and Type B programs |   | \$ 521,635                  |
| 7. | Low-risk audited  | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

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

**Section II. Financial Statement Findings**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
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Section 8	03-II-1	<b>Undistributed Debits and Credits</b>	
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Criteria and Condition

As in prior years, our audit revealed the Municipality's failure to properly implement internal controls and procedures to maintain an adequate and complete set of accounting records and reports. The Municipality failed to properly post and register its financial transactions related with payroll taxes and withholdings, as well as properly identify the concept and source of certain cash receipts known as undistributed debits and credits, of Section 8 programs in accordance with generally accepted accounting principles. The undistributed debits and credits for all Section 8 and moderate programs amounted to \$615,906 and \$372,067 respectively, at June 30, 2003. This finding is repeated from prior years.

Cause

The Section 8 voucher program bank account was selected in 1996 to receive all federal funds assigned to voucher, certificate and moderate programs. However, when payroll tax withholding and employer's contributions were paid, as well as certain cash receipts adequate detail were not maintained by the programs. Therefore, amounts belonging to each programs were recorded as undistributed debits and credits.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2003

Section II. Financial Statement Findings

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
Section 8	03-II-1	<b>Undistributed Debits and Credits (Continuation)</b>  <u>Effect</u>  The programs account balances related with this payroll taxes and withholding as well as certain cash receipts were incorrect.  <u>Recommendation</u>  We again recommend an analysis of all undistributed debits and credits account in order to distribute them to the proper federal program.  <u>Management Comments</u>  The program employees continue analyzing the undistributed credits and debits to determine the appropriate adjustments to the accounting records.	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

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

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
Section 8	03-III-1	<b>Cash Management</b>	

Criteria and Condition

The Cash Management General Requirement of Circular OMB 102 requires that funds should include procedures to minimize the time elapsed between the transfer of funds from the U.S. Treasury and the disbursement of funds by the grantee. During our examination of the voucher and existing bank accounts, we noted cash balances of the programs amounting to approximately \$520,000, including \$6,671 interest earned, at June 30, 2003. The program total expenditures amounted to approximately \$3,751,000 for the year, which averages \$312,600 monthly. Therefore, the program maintains the equivalent of almost two-month cash. This finding is repeated from prior years, except the amounts are different.

Cause

The Section 8 program had an excess of cash, due to once the budgeted amount is approved by HUD the funds are transferred monthly to the bank account but, partially is due to the incorrect balances of the undistributed debits and credits described in finding 03-II-1, less expenses incurred than budgeted in current year and the operating reserve required to be maintained.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

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

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
Section 8	03-III-1	<p><b>Cash Management (Continuation)</b></p> <p><u>Effect</u></p> <p>Cash balance maintained is in excess of needs of the program.</p> <p><u>Recommendation</u></p> <p>For Section 8 programs, we recommend that cash should be requested based on current needs and if actual expenditures will be less than the budgeted amount the cash requisition should be modified. Also, we recommend that the undistributed debits and credits should be analyzed and excess cash determined should be reimbursed to HUD or credited from future budget amounts.</p> <p><u>Management Comments</u></p> <p>Municipality officials informed that once the year-end closing is completed the excess cash determined for the current year is withheld from the next year budget. In relation with any other possible excess cash related with the undistributed debits and credits an analysis of such accounts is expected to be completed during 2003-2004 and any excess cash determined will be reimbursed to the federal agency.</p>	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ**

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

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
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FEMA	03-III-2	<p><b>Period of Availability of Federal Funds</b></p>	
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Criteria and Condition

The OMB Circular A-133 (Revised) compliance H, states that the programs may charge allowable costs resulting from obligations incurred during the funding period up to the approved grant amount. In addition, entities should liquidate all obligations incurred under the award not later than 90 days after the end of the funding period. During our examination of FEMA funds, we noted that there is a balance of \$2.3 millions on obligations balances for more that 3 years. These debt is related with serious physical damages caused by the Hurricane Georges is September 1998.

Cause

The Municipality contracted various service providers to clean up the rubbles , mud, fix roads, bridges and repair other physical damages caused by the Hurricane. Therefore, the Municipality officials claimed FEMA to reimburse for the costs incurred; however, the federal agency approval and reimbursements have not been sufficient to cover all costs incurred.

Effect

The Municipality has not been able to pay such service providers and, therefore, they have filed legal claims against the Municipality before the Superior Court of Puerto Rico.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2003

**Section III Federal Award Findings and Questioned Costs**

<u>Program</u>	<u>Finding Number</u>	<u>Findings/Non-Compliance</u>	<u>Questioned Costs</u>
FEMA	03-III-2	<b>Period of Availability of Federal Funds</b>  <u>Recommendation</u>  We recommend the Municipality officials to continue claiming FEMA the reimbursement for all costs incurred.  <u>Management Comments</u>  Municipality officials informed that the 90 days the requirement apply after the projects of the federal program are completed.	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ  
PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
For the year ended June 30, 2003**

<b>Single Audit Report</b>	<b>Program</b>	<b>Finding No.</b>	<b>Finding</b>	<b>Current Status</b>
6/30/2002 Report Dated	CDBG	02-II-1	<p style="text-align: center;"><b><u>Accounting Records</u></b></p> <p>The Municipality does not maintain complete accounting records related with general journal nor general ledger to prepare correct monthly, quarterly and year-end financial statements.</p>	Certain improvements was noted during the fiscal year 2002-2003.
	Section 8	02-II-2	<p style="text-align: center;"><b><u>Undistributed Debits and Credits</u></b></p> <p>The Municipality failed to properly implement internal control and procedures to maintain an adequate and complete set of accounting records and reports. The Municipality failed to properly post and register its financial transactions related with payroll taxes and credits, of Section 8 programs in accordance with generally accepted accounting principles.</p>	Finding repeated this year and still prevails. See finding 03-II-1.
	CDBG, Local Funds	02-II-3	<p style="text-align: center;"><b><u>Fixed Assets</u></b></p> <p>The Municipality did not maintain adequate accounting records to account for all the real and personal properties of all the Municipality funds; federal and non federal.</p>	The Municipality complied with GASB 34 which covered all capital assets during 2002-2003.
	Section 8	02-III-1	<p style="text-align: center;"><b><u>Cash Management</u></b></p> <p>The federal programs Section 8 Voucher, Certificates and Moderate maintained excess cash during the year 2001-2002. There were \$73,558 questioned excess cash.</p>	The Municipality returned the \$73,558; however, it keeps maintaining excess cash as noted in current year 2002-2003. See finding 03-III-1.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ  
PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
For the year ended June 30, 2003**

<b>Single Audit Report</b>	<b>Program</b>	<b>Finding No.</b>	<b>Finding</b>	<b>Current Status</b>
6/30/2002 Report Dated	Section 8	02-III-2	<u><b>Special Test and Provisions</b></u> <u><b>Waiting List</b></u> The Municipality was not following the procedures required by Section 982.07 of 24 CFR in admitting new tenants participants.	The Municipality has improved following the procedures but, not in all cases.
6/30/2001 Report Dated 2/4/2002	CDBG	01-II-1	<u><b>Accounting Records</b></u> The Municipality does not maintain adequate accounting records for this federal program.	The Municipality's federal program improved their accounting records during the year 2002-2003.
	Section 8	01-II-2	<u><b>Undistributed Debits and Credits</b></u> The Municipality failed to properly implement internal control and procedures to maintain an adequate and complete set of accounting records and reports. The Municipality failed to properly post and register its financial transactions related with payroll taxes and credits, of Section 8 programs in accordance with generally accepted accounting principles.	Finding repeated this year and still prevails. See finding 03-II-1.
	CDBG, Local Funds	01-II-3	<u><b>Fixed Assets</b></u> The Municipality did not maintain adequate accounting records to account for all the real and personal properties of all the Municipality funds; federal and non federal.	The Municipality complied with GASB 34 which covered all capital assets during 2002-2003.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ  
PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
For the year ended June 30, 2003**

<b>Single Audit Report</b>	<b>Program</b>	<b>Finding No.</b>	<b>Finding</b>	<b>Current Status</b>
6/30/2001 Report Dated 2/4/2002	Section 8	01-III-2	<u>Cash Management</u> Cash balance in excess of current needs which should be returned to HUD or deducted from future approved budgets.	Finding repeated this year and still prevails. See finding 03-III-1.
	Section 8	01-III-3	<u>Special Tests and Provisions</u> <u>Waiting Lists</u> New participants were admitted tot the program who were not listed in the waiting list.	The Municipality has improved following the procedures but, not in all cases.
	Section 8	01-III-4	<u>Eligibility</u> The program was not in compliance with participants eligibility as required by 24CFR.	The Municipality's federal program complied with the eligibility requirement during 2002-2003.
6/30/2000 Report Dated 1/19/2001	CDBG	00-II-1	<u>Accounting Records</u> The Municipality does not maintain adequate accounting records for this federal program.	The Municipality's federal program improved their accounting records during the year 2002-2003.
	Section 8 & Moderate	00-II-3	<u>Undistributed Debits and Credits</u> The Municipality failed to properly implement internal control and procedures to maintain an adequate and complete set of accounting records and reports. The Municipality failed to properly post and register its financial transactions related with payroll taxes and credits, of Section 8 programs in accordance with generally accepted accounting principles.	Finding repeated this year and still prevails. See finding 03-II-1.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF MAYAGÜEZ  
PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
For the year ended June 30, 2003**

<b>Single Audit Report</b>	<b>Program</b>	<b>Finding No.</b>	<b>Finding</b>	<b>Current Status</b>
6/30/2000 Report Dated 1/19/2001	Section 8	00-III-2	<b><u>Cash Management</u></b> The program is not complying to minimize the time elapsed between the funds received and disbursed.	Finding repeated this year and still prevail. See finding 03-III-1.
06/30/1999 Report Dated 3/03/2000	FEMA, CDBG & HOME	99-II-1	<b><u>Accounting Records</u></b> The Municipality does not maintain adequate accounting records for each federal program.	The Municipality's federal programs improved their accounting records during 2002-2003.
	Section 8	99-II-3	<b><u>Undistributed Debits and Credits</u></b> The Municipality failed to properly implement internal control and procedures to maintain an adequate and complete set of accounting records and reports. The Municipality failed to properly post and register its financial transactions related with payroll taxes and credits, of Section 8 programs in accordance with generally accepted accounting principles.	Finding repeated this year and still prevails. See finding 03-II-1.
	CDBG	99-III-1	<b><u>Cash Management</u></b> Section 21 of OMB Circular A-102, Common Rule and 24 CFR requires that funds should include procedures to minimize the time elapsed between the transfer of funds form HUD and the disbursement of funds by the grantee. During our test of 12 noted that all were issued after the five days required.	Finding repeated this year and still prevails. See finding 03-III-1.