

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

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

Cash No. 5-9452

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

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditor's Report	1-2
Required Supplemental Information (Part 1) Management's Discussion and Analysis	3-13
Government-Wide Financial Statements:	
Statement of Net Assets	14
Statement of Activities	15
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	16
Statement of Revenues, Expenditures and Changes in Fund Balances	17
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	18
Notes to basic financial statements	19-42
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplemental Information (Part II):	
Budgetary Comparison Schedule-General Fund	43
Notes to Budgetary Comparison Schedule-General Fund	44
Schedule of expenditures of federal awards	45-46
Notes to the schedule of expenditures of federal awards	47
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Independent auditors' report on compliance and on internal control over financial reporting based on an audit of basic financial statements performed in accordance with <i>Government Auditing Standards</i>	48-49

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SINGLE AUDIT REPORT

YEAR ENDED JUNE 30, 2004

CONTENTS -(CONTINUED)

	Page
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)</u>	
Independent auditors' report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A- 133	50-52
<u>FINDINGS AND QUESTIONED COSTS</u>	
Schedule of findings and questioned cost	53-77
Summary schedule of prior year audit findings	78-82



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

INDEPENDENT AUDITORS' REPORT

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Peñuelas
Peñuelas, 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 Peñuelas, Puerto Rico**, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of the Office of Management and Budget Circular A-133, "*Audits of States, Local Governments, and Non-Profit Organizations*". Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 12, the Municipality has not maintained complete and adequate records in order to obtain sufficient and competent evidential matter related to the Capital Assets reported in the governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the third paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the **Municipality of Peñuelas, Puerto Rico**, as of June 30, 2004, and the changes in financial position, thereof for the year then ended.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

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

The Management's Discussion and Analysis on pages 3 through 13 and the Budgetary Comparison Schedule-General Fund on page 43 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2004 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

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


LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 20, 2004

Stamp No. 2019445 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2004

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

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

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2004 deserve special mention:

1. Total assets of the Municipality amounted to \$24,032,706 which represents no variance compared to prior fiscal year;
2. At the end of fiscal year 2004, total liabilities amounted to \$29,942,143. Out of said amount, \$24,415,523 corresponded to long-term liabilities of which \$12,746,000 represented the outstanding balance of bonds issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
3. Total net assets (deficit) of the Municipality amounted to (\$5,909,437) which represents an increase of 33% compared to prior fiscal year;
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$21,296,069, derived from the following sources: \$349,256 charges for services; \$6,063,309 from operating grants and contributions; \$2,866,246 from capital grants and contributions obtained from other sources, and \$12,017,258 from general revenues available;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$22,587,488;
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to a decrease in the Net Assets figure by (\$1,291,419);
7. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of \$7,609,079;
8. As the end of the current fiscal year the Municipality's General Fund balance amounted to \$18,270, compared to a fund deficit of (\$1,948,290) in the prior fiscal year;
9. The actual General Fund budgetary activities resulted in an unfavorable balance of (\$260,041), caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

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

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

FINANCIAL STATEMENTS COMPONENTS

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

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

A brief review of The Statements of Activities of the Municipality at June 30, 2004, shows total expenses incurred to afford the cost of all functions and programs amounted to \$22,587,488. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$9,278,811 was derived from the following sources: \$349,256 charges for services; \$6,063,309 from operating grants and contributions; and \$2,866,246 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$12,017,258. When such figure is added to the \$9,278,811 previously mentioned, total revenues available for the financing of activities amounted to \$21,296,069. There was an excess of expenses over revenues in the amount of \$1,291,419 which contributed with a decrease to the figure of net assets attained at the end of the fiscal year.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

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

INFRASTRUCTURE ASSETS

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

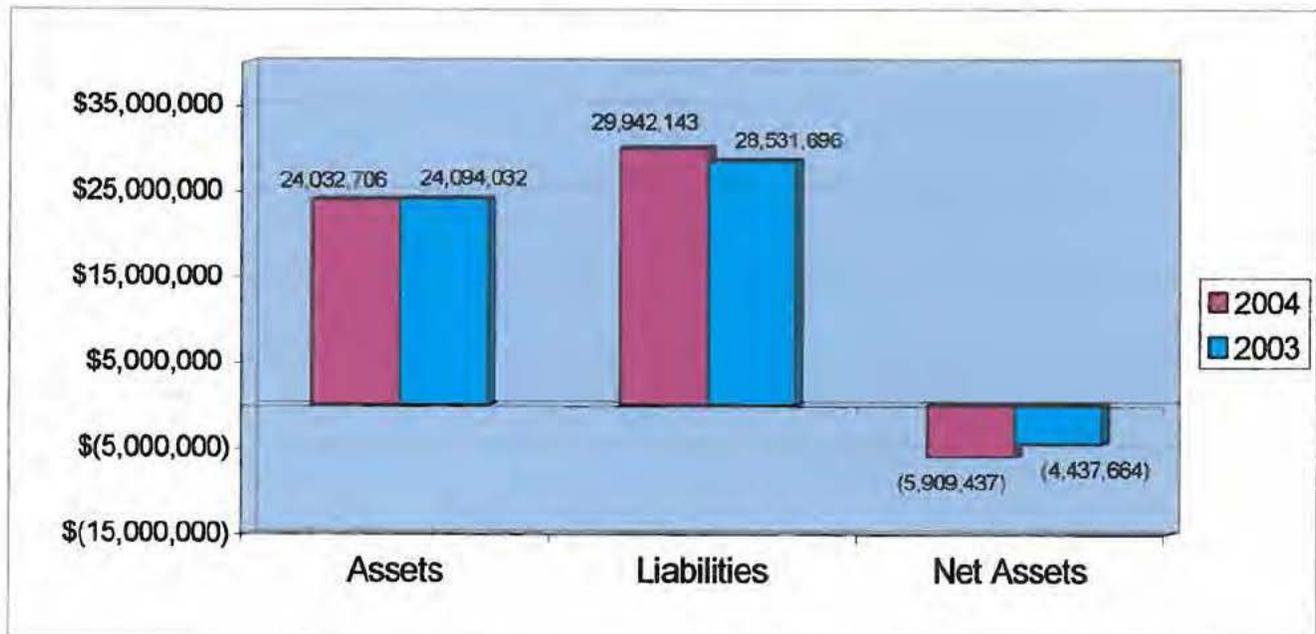
YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Peñuelas, primary government liabilities exceeded total assets by \$5,909,437 at the end of 2004, compared to \$4,618,018 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets	2004	2003	Change	%
Current and other assets	\$ 12,855,919	\$ 13,008,011	\$ (152,092)	(1%)
Capital assets	11,176,787	11,086,021	90,766	1%
Total assets	24,032,706	24,094,032	(61,326)	-
Current and other liabilities	5,526,620	4,796,973	729,647	15%
Long-term liabilities	24,415,523	23,734,723	680,800	3%
Total liabilities	29,942,143	28,531,696	1,410,447	5%
Invested in capital assets, net of related debt	2,617,537	2,256,971	360,566	16%
Restricted	7,311,029	9,923,351	(2,612,322)	(26%)
Unrestricted deficit	(15,838,003)	(16,617,986)	779,983	(5%)
Total net assets	\$ (5,909,437)	\$ (4,437,664)	\$ (1,471,773)	33%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2004, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to (\$1,291,419) decrease in the Municipality's net assets. Approximately 36 percent of the Municipality's total revenue came from taxes, while 60 percent resulted from grants and contributions, including federal aid. Charges for Services provided 1 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, health and welfare services, public works, and community development. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

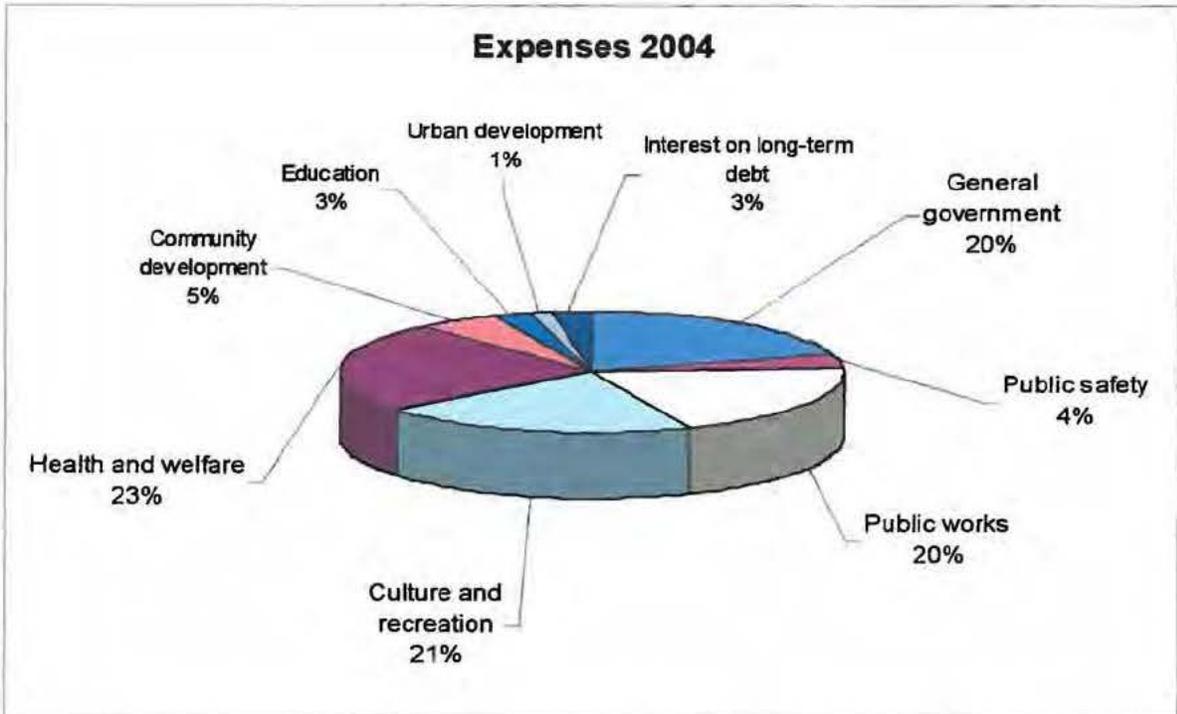
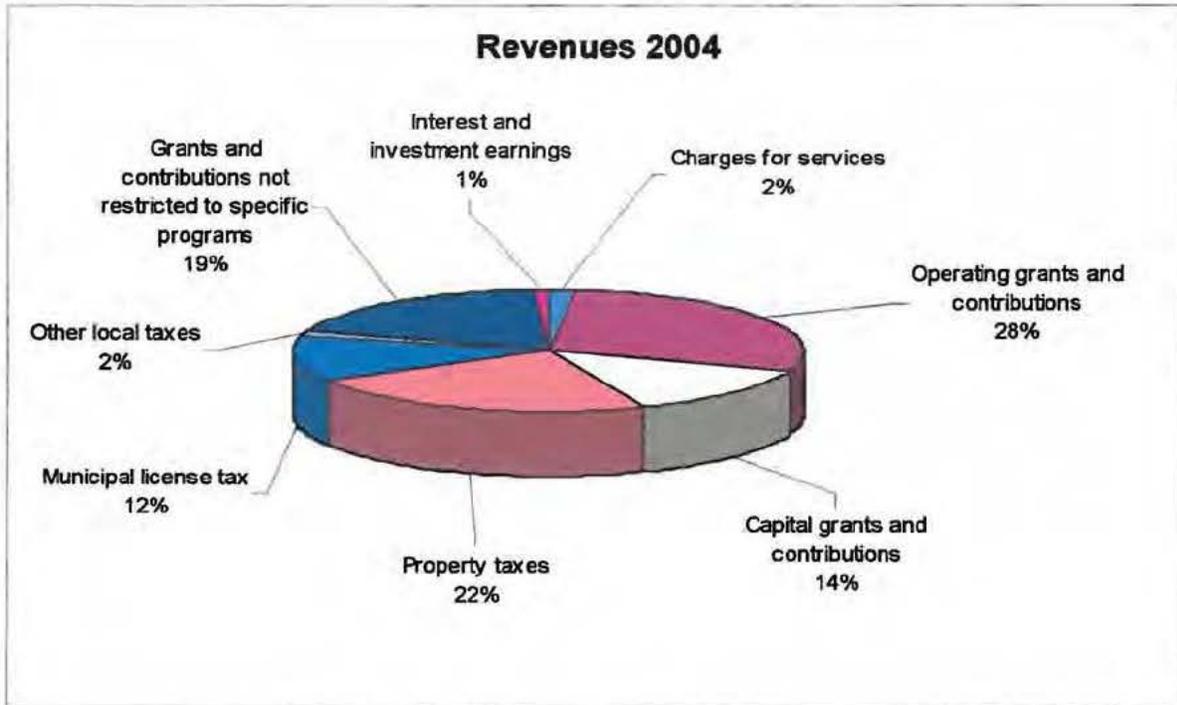
Condensed Statement of Activities	2004	2003	Change	%
Program revenues:				
Charges for services	\$ 349,256	\$ 194,933	\$ 154,323	79%
Operating grants and contributions	6,063,309	5,233,569	829,740	16%
Capital grants and contributions	2,866,246	3,774,930	(908,684)	(24%)
General revenues:				
Property taxes	4,776,411	4,988,390	(211,979)	(4%)
Municipal license tax	2,579,026	3,621,384	(1,042,358)	(29%)
Other local taxes	400,059	586,922	(186,863)	(32%)
Grants and contributions not restricted to specific programs	3,999,113	2,530,658	1,468,455	58%
Interest and investment earnings	151,163	186,760	(35,597)	(19%)
Miscellaneous	111,486	14,442	97,044	672%
Total revenues	21,296,069	21,131,988	164,081	1%
Expenses:				
General government	4,599,698	3,844,571	755,127	20%
Public safety	822,844	902,536	(79,692)	(9%)
Public works	4,405,351	3,611,082	794,269	22%
Culture and recreation	4,676,782	1,034,697	3,642,085	352%
Health and welfare	5,458,764	5,520,382	(61,618)	(1%)
Community development	1,189,055	35,853	1,153,202	3216%
Education	581,436	449,544	131,892	29%
Urban development	260,073	130,084	129,989	100%
Interest on long-term debt	593,485	552,920	40,565	7%
Total expenses	22,587,488	16,081,669	6,505,819	40%
Change in net assets	(1,291,419)	5,050,319	(6,341,738)	(126%)
Net assets, beginning of year	(4,618,018)	(9,668,337)	5,050,319	(52%)
Net assets, end of year	\$ (5,909,437)	\$ (4,618,018)	\$ (1,291,419)	28%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$7,609,079, a decrease of \$661,957 in comparison with the prior year. There are reservations of fund balance amounting to \$7,748,000. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$157,191), 2) to pay debt service (\$2,295,909), 3) to pay for capital projects (\$3,378,307) and 4) for other purposes (\$1,916,593).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2004, the general fund has an undesignated fund deficit of \$138,921.

GENERAL FUND BUDGETARY HIGHLIGHTS

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

The actual General Fund budgetary activities resulted in an unfavorable balance of (\$260,041), caused mainly due to unexpected variances in revenue collections from miscellaneous sources.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$15,448,571, net of accumulated depreciation of \$8,079,979 (including depreciation charges for the year totaled \$721,610), leaving a net book value of \$11,176,787. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2004, the Municipality has \$1,140,007 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2004-2005.

FINAL COMMENTS

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

In order to finance its general fund deficit, which is the chief operating fund of the Municipality, the Municipality has raised funds from long term borrowing expedited thru the Government Development Bank for Puerto Rico acting as its Fiscal Agency. On June 2004, it issued a general obligation note in the amount of \$1,195,000. The proceeds of said loan, executed at a very reasonable interest rate will be used for payment of advance property tax debt owned to the Municipal Revenue Collection Center ("CRIM") resulting from fiscal year 2002-2003 final liquidation.

On September 7, 2004, Public Law 255 was enacted to amend Section 22 of the Public Law 83 of May 2, 1941, know as the Puerto Rico Electric Power Authority ("PREPA") Act. This Law stipule a new formula to determine the contribution in lieu of taxes to be distributed to the Municipalities of the Commonwealth of Puerto Rico. From fiscal year 2002-2003 the PREPA is required by law to distribute as contribution in lieu of taxes a twenty percentage of its net revenues, after deduction of subsidies granted, or an amount equal to the actual cost of electric power consumed by each Municipality, or an average of the contribution in lieu of taxes paid to each Municipality in the last most recent five fiscal years, whichever is greater.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 10, Peñuelas, Puerto Rico 00624-0010, or call (787) 836-1218.

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

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 6,005,728
Cash with fiscal agent	3,105,080
Accounts receivable:	
Municipal license tax	
Intergovernmental	3,720,141
Federal	
Other	24,970
Capital assets	
Land, improvements, and construction in progress	3,808,195
Other capital assets, net of depreciation	7,368,592
Total capital assets	11,176,787
 Total assets	 24,032,706
 Liabilities	
Accounts payable and accrued liabilities	1,270,061
Due to other governmental entities	1,254,918
Claims and Judgments	
Deferred revenues:	
Municipal license tax	2,153,840
Federal grant revenues	568,021
Other	
Interest payable	279,780
Noncurrent liabilities:	
Due within one year	1,501,420
Due in more than one year	22,914,103
 Total liabilities	 29,942,143
 Net Assets	
Invested in capital assets, net of related debt	2,617,537
Restricted for:	
Capital projects	3,378,307
Debt service	2,016,129
Other purposes	1,916,593
Unrestricted (deficit)	(15,838,003)
 Total net assets	 \$ (5,909,437)

**Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Activities
For the Year Ended June 30, 2004**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 4,599,698	\$ -	\$ 173,208	\$ -	\$ (4,426,490)
Public safety	822,844	299		10,335	(812,210)
Public works	4,405,351	18,080		764,264	(3,623,007)
Health and welfare	5,458,764		4,726,998		(731,766)
Culture and recreation	4,676,782	15,877	131,695	963,660	(3,565,550)
Economic development	581,436		925,340		343,904
Community development	1,189,055		61,068	1,127,987	-
Education	260,073	315,000	45,000		99,927
Interest on long-term debt	593,485				(593,485)
Total governmental activities	\$ 22,587,488	\$ 349,256	\$ 6,063,309	\$ 2,866,246	(13,308,677)
General revenues:					
Property taxes					4,776,411
Municipal license tax					2,579,026
Other local taxes					400,059
Grants and contributions not restricted to specific programs					3,999,113
Interest and investment earnings					151,163
Miscellaneous					111,486
Total general revenues					12,017,258
Change in net assets					(1,291,419)
Net assets (deficit) - beginning, as restated					(4,618,018)
Net assets (deficit) - ending					\$ (5,909,437)

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

	General Fund	Special Revenue Fund - Local & State Grants	Special Revenue Fund Head Start	Special Revenue Fund Other Federal Grants	Capital Projects Fund - Local, State & Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets								
Cash and cash equivalents	\$ 268,791	\$ 2,036,679	\$ 509,114	\$ 332,461	\$ 2,504,445	\$ -	\$ 354,238	\$ 6,005,728
Cash with fiscal agent	67,066	7,418			1,140,007	1,890,589		3,105,080
Accounts receivable:								-
Intergovernmental	1,917,894	297,346	126,646	802,115	168,535	407,605		3,720,141
Other	23,768					1,202		24,970
Due from other funds	1,495,072							1,495,072
Total assets	\$ 3,772,591	\$ 2,341,443	\$ 635,760	\$ 1,134,576	\$ 3,812,987	\$ 2,299,396	\$ 354,238	\$ 14,350,991
Liabilities and Fund Balances								
Liabilities :								
Accounts payable and accrued liabilities	\$ 345,563	\$ 13,759	\$ 108,287	\$ 519,453	\$ 282,999	\$ -	\$ -	\$ 1,270,061
Due to other governmental entities	1,254,918							1,254,918
Due to other funds		411,091	471,488	387,927	151,681	3,487	69,398	1,495,072
Claim and Judgment								-
Deferred revenues:								
Municipal license tax	2,153,840							2,153,840
Federal grant revenues			55,985	227,196			284,840	568,021
Total liabilities	3,754,321	424,850	635,760	1,134,576	434,680	3,487	354,238	6,741,912
Fund balances:								
Reserved for:								
Encumbrances	157,191							157,191
Capital projects					3,378,307			3,378,307
Debt service fund						2,295,909		2,295,909
Other purposes		1,916,593						1,916,593
Reserved reported in nonmajor funds:								
Other purposes								-
Unreserved:								
Undesigned (Deficit)	(138,921)							(138,921)
Total fund balances	18,270	1,916,593	-	-	3,378,307	2,295,909	-	7,609,079
Total liabilities and fund balances	\$ 3,772,591	\$ 2,341,443	\$ 635,760	\$ 1,134,576	\$ 3,812,987	\$ 2,299,396	\$ 354,238	

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

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	11,176,787
Long-term liabilities, including interest payable, are not due and payable in the current period, and therefore, are not reported in the funds	(24,546,634)
Net assets of governmental activities	\$ (5,760,768)

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

	General Fund	Special Revenue Fund - Local & State Grants	Special Revenue Fund Head Start Program	Special Revenue Fund Other Federal Grants	Capital Projects Fund - Local, State & Federal Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues								
Property taxes	\$ 3,430,001	\$ -	\$ -	\$ -	\$ -	\$ 1,274,215	\$ -	\$ 4,704,216
Municipal license taxes	2,579,026							2,579,026
Licenses, permits and other local taxes	400,889							400,889
Charges for services	33,127							33,127
Intergovernmental	4,116,393	1,858,096			1,507,023			7,481,512
Interest	151,163							151,163
Federal grants			3,654,056	1,334,183			834,496	5,822,735
Miscellaneous	103,375	7,120			1,290		11,616	123,401
Total revenues	10,813,974	1,865,216	3,654,056	1,334,183	1,508,313	1,274,215	846,112	21,296,069
Expenditures								
Current:								
General government	4,139,712	188,122			889			4,328,723
Public safety	842,325	1,030		10,335				853,690
Public works	3,224,014	506,338		155,184	673,173			4,558,709
Health and welfare	819,018	246,193	3,654,056	29,609			846,112	5,594,988
Culture and recreation	851,029	203,298			3,696,111			4,750,438
Economic development		581,436						581,436
Community development		50,000		1,139,055				1,189,055
Education	87,319	173,986						261,305
Debt service:								
Principal						485,000		485,000
Interest						549,682		549,682
Total expenditures	9,963,417	1,950,403	3,654,056	1,334,183	4,370,173	1,034,682	846,112	23,153,026
Excess (deficiency) of revenues over (under) expenditures	850,557	(85,187)	-	-	(2,861,860)	239,533	-	(1,856,957)
Other financing sources (uses)								
Transfers in	194,754	95,000				238,750		528,504
Transfers out	(333,750)	(194,754)						(528,504)
Long-term debt issued	1,195,000							1,195,000
Total other financing sources (uses)	1,056,004	(99,754)	-	-	-	238,750	-	1,195,000
Net change in fund balances	1,906,561	(184,941)	-	-	(2,861,860)	478,283	-	(661,957)
Fund balance (deficit) beginning, as restated	(1,888,291)	2,101,534			6,240,167	1,817,626		8,271,036
Fund balance (deficit), ending	\$ 18,270	\$ 1,916,593	\$ -	\$ -	\$ 3,378,307	\$ 2,295,909	\$ -	\$ 7,609,079

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

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

Net Change in Fund Balances - Total Governmental Funds	\$ (661,957)
 Amounts reported for governmental activities in the Statement of Activities are different because:	
Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.	812,376
Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds.	(721,610)
Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Assets, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represented the change in accrued interest from prior year.	(43,803)
Bonds and notes proceeds provides current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long - term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments.	(710,000)
Repayment of long term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period.	154,423
Repayment of long term Treasury Department debt is an expenditure in Governmental Funds, but the repayment reduces long -term debt in the Government-Wide Statement of Net Assets. The following amount represent the change in long-term debt with the Treasury Department from prior year.	217,490
Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represent the change in long-term compensated absences from prior year.	(309,845)
Long-term claims and judgements are reported in the Governmental-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, claims and judgments are not reported as expenditures in Government Funds. The following amount represent the change in long-term claims and judgments from prior year.	(28,493)
Change in Net Assets of Governmental Activities	<u><u>\$ (1,291,419)</u></u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2004

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Peñuelas (the Municipality) was founded on the year 1793. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a fourteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

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

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

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

Special Revenue Fund - Head Start- Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

C. Financial reporting presentation

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

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

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

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

Special Revenue Fund – Head Start - Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

D. Measurement focus, basis of accounting and financial presentation

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

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, rent, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Assets, liabilities and net assets

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

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

- 2. Receivables and payables-** Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represents mostly contributions from the Puerto Rico Electric Power Authority (PREPA), which, pays the municipalities as contributions in lieu of taxes greater of the following amounts: (a) twenty percent (20%) of its net revenues as defined in the Trust Indenture signed with the Trustee as representative of the bondholders, adjusted by subsidies granted by the PREPA; (b) an amount equal to the actual cost of electric power consumed by each Municipality in its common facilities during the current year; or (c) an average of the contribution in lieu of taxes paid by PREPA to each municipality during the past five fiscal years. The contribution in lieu of tax revenue and related receivable recorded in the General Fund for the current fiscal year was determined based on revenue estimates made by the PREPA and actual transactions during the current fiscal year, because the final contribution amount from the PREPA was not available at the date of release of the basic financial statements. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

3. **Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

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

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

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

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

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

- 7. Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

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

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2004 amounted to approximately \$187,201. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$330,976 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

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

1.1 Reconciliation of Government-wide and Fund Financial Statements

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

		<u>Total Net Assets</u> <u>Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 11,176,787	
Deduct:		
Bonds Payable	<u>(8,559,250)</u>	\$ 2,617,537
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		3,378,307
<u>Net assets restricted for debt service</u>		
Debt service fund - fund balance	\$ 2,295,909	
Deduct:		
Interest payable	<u>(279,780)</u>	2,016,129
<u>Net assets restricted for other purposes</u>		
Special revenue fund - local and state grants restricted		1,916,593
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 18,270	
Deduct:		
Bonds Payable	(4,186,750)	
Treasury Department - Claims	(3,174,771)	
Property Tax Debt	(6,761,971)	
Compensated Absences	(1,539,798)	
Claims and judgments	<u>(192,983)</u>	<u>(15,838,003)</u>
Total net assets - governmental activities		<u>\$ (5,909,437)</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$268,791 in the general fund, \$2,036,679 in the special revenue fund - state and local grants, \$509,114 in the special revenue fund - head start, \$332,461 in the special revenue fund - other federal grants, and \$2,504,445 in the capital project fund - local, state and federal grants were fully collateralized at June 30, 2004. In the other governmental funds there were deposits with commercial banks of approximately \$354,238 that were fully collateralized.

The deposits at GDB of approximately \$67,066, that is restricted for other purposes in the general fund, the \$7,418 in the special revenue fund - local and state grants, the \$1,140,007 that is restricted principally for capital projects in the capital project fund - local, state and federal grants, and the \$1,890,589 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal License Tax*- The Municipality impose a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2004, the tax rates were as follows:

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

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2004, net of allowance for uncollectible.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. RECEIVABLES (CONTINUED)

B. Intergovernmental Receivables- Intergovernmental receivables in the general fund principally consist of the amount due from the Government Development Bank for Puerto Rico (GDB) related to a bond authorized by the Municipal Assembly and GDB for approximately \$1,195,000 and disbursed by the GDB on July 6, 2004 to pay debt owned by the Municipality to the Municipal Revenue Collection Center ("CRIM") of the Commonwealth of Puerto Rico related to the fiscal year 02-03 final liquidation, the amounts due from the CRIM resulting from property tax collections related to the amnesty granted through the Public Law 74, enacted on March 1, 2004, the amounts due from the CRIM resulting from the excess of current year property tax collections over current year advances, the amounts due from the Puerto Rico Electric Power Authority ("PREPA") resulting from the estimated revenues the Municipality is entitled to receive in lieu of payment of taxes over actual cost of electric power consumed by the Municipality during the current fiscal year, and the amount owned by the Department of Education of the Commonwealth of Puerto Rico resulting for transportation services rendered by the Municipality.. The amount receivable from governmental entities is as follows:

<u>Governmental Entity</u>	<u>Amount</u>
Government Development Bank of Puerto Rico ("GDB")	\$ 1,195,000
Municipal Revenue Collection Center ("CRIM")	495,870
Municipal Revenue Collection Center ("CRIM")	104,542
Department of Education	82,500
Puerto Rico Electric Power Authority ("PREPA")	<u>39,982</u>
Total	<u>\$ 1,917,894</u>

On September 7, 2004, Act Num. 255 was enacted and a new formula as described in Note 1 (E) (2), was established for the calculation of the contribution in lieu of taxes to be paid to the municipalities by PREPA. Since the final liquidation following such formula was not available for fiscal year 2003-2004, an estimated amount was recognized, based on the estimate contributions in lieu of taxes determined by PREPA for the current fiscal year.

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

<u>Program Description</u>	<u>Amount</u>
Department of Labor – Law 52 Grant	\$ 283,346
"Desarrollo Económico y Autogestión" Grant	<u>14,000</u>
Total	<u>\$ 297,346</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. RECEIVABLES (CONTINUED)

Intergovernmental receivable in special revenue fund - head start represent expenditures incurred not yet reimbursed by the pass-through grantor. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Head Start	\$ 126,646
Total	\$ 126,646

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

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant	\$ 742,343
Public Assistance Grant	21,136
Edward Byrne Memorial	15,415
Hazard Mitigation	23,221
Total	\$ 802,115

Intergovernmental receivable in capital project fund - local, state and federal grants represent expenditures incurred not yet reimbursed by another governmental entity. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
"Corporación de Desarrollo Rural"	\$ 168,535
Total	\$ 168,535

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

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ 407,605
Total	\$ 407,605

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2004, and interfund transfers during the fiscal year ended at June 30, 2004, are summarized as follows:

a. Due from/to other fund:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund - Local and State Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	\$ 411,091
General Fund	Special Revenue Fund - Head Start	Payroll and related accruals paid and not reimbursed.	471,488
General Fund	Special Revenue Fund - Other Federal Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	387,926
General Fund	Capital Project Fund - Local, State and Federal Grants	Reimbursable expenditures	151,681
General Fund	Debt Service Fund	Interest Revenue	3,488
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	<u>69,398</u>
Total			<u>\$ 1,495,072</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt retirement	\$ 238,750
General Fund	Special Revenue Fund - Local and State Grants	Transfer of funds for capital outlays	95,000
Special Revenue Fund - Local and State Grants	Debt Service Fund	Residual equity transfer	<u>194,754</u>
Total			<u>\$ 528,504</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2004, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2004</u>
Capital asset, not being depreciated:				
Land	\$ 659,123	\$ -	\$ -	\$ 659,123
Construction in progress	<u>3,149,072</u>	<u>-</u>	<u>-</u>	<u>3,149,072</u>
Total capital assets not being depreciated	<u>\$ 3,808,195</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,808,195</u>
Capital assets, being depreciated:				
Buildings	\$ 5,706,896	\$ -	\$ -	\$ 5,706,896
Buildings improvements				
Infrastructure	4,429,863			4,429,863
Infrastructure improvements	228,502			228,502
Equipment	1,027,407	208,014		1,235,421
Furnishing				
Computers				
Vehicles	<u>3,243,527</u>	<u>604,362</u>	<u>-</u>	<u>3,847,889</u>
Total capital assets being depreciated	<u>\$ 14,636,195</u>	<u>\$ 812,376</u>	<u>\$ -</u>	<u>\$ 15,448,571</u>
Less accumulated depreciation for:				
Buildings	\$ (2,181,981)	\$ (202,417)		\$ (2,384,398)
Buildings improvements				
Infrastructure	(1,925,497)	(193,872)		(2,119,369)
Infrastructure improvements	(85,674)	(10,444)		(96,118)
Equipment	(829,746)	(90,596)		(920,342)
Furnishing				
Computers				
Vehicles	<u>(2,335,471)</u>	<u>(224,281)</u>	<u>-</u>	<u>(2,559,752)</u>
Total accumulated depreciation	<u>\$ (7,358,369)</u>	<u>\$ (721,610)</u>	<u>\$ -</u>	<u>\$ (8,079,979)</u>
Total capital assets being depreciated, net	<u>\$ 7,277,826</u>	<u>\$ 90,766</u>	<u>\$ -</u>	<u>\$ 7,368,592</u>
Governmental activities capital assets, net	<u>\$ 11,086,021</u>	<u>\$ 90,766</u>	<u>\$ -</u>	<u>\$ 11,176,787</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General government	\$ 480,031
Public safety	46,015
Public works	115,887
Culture and recreation	26,520
Health and welfare	<u>53,157</u>
Total depreciation expense-governmental activities	<u>\$ 721,610</u>

6. PROPERTY TAXES

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

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

On December 31, 1992 the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2004, the related unpaid property tax advances presented in the statement of net assets amounted to approximately \$4,341,291

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES (CONTINUED)

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

Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26 1997, Public Law Num. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law. As of June 30 2004, the related unpaid property tax advances presented in the Statement of Net Assets amounted to approximately \$2,258,764.

The government-wide statement of net assets includes an outstanding debt balance of \$1,645,607 and \$775,073 related to Law 42 and Law 146, respectively.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

6. PROPERTY TAXES (CONTINUED)

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$ 15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$ 50,000 of the assessed value to retailers having annual net sales of less than \$ 150,000.

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

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

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

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ 1,187,449
State Insurance Fund ("FSE")	39,143
Puerto Rico Aqueduct and Sewer Authority	21,494
General Services Administration	<u>6,832</u>
Total	<u>\$ 1,254,918</u>

8. DEFERRED REVENUES

A. Municipal License Tax- The deferred revenues of approximately \$2,153,840 in the general fund relates to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

Federal Government- The deferred revenues presented in the special revenue fund – head start represents the portion of federal grant received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child and Adult Care Food Program	<u>\$ 55,985</u>
Total	<u>\$ 55,985</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

8. DEFERRED REVENUES (CONTINUED)

The deferred revenues presented in the special revenue fund - other federal grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Public Safety Partnership and Community Policing Grant	\$ 113,590
Emergency Management - State and Local Assistance	13,564
Public Assistance Grant	33,609
Local Law Enforcement Block Grant	2,660
Others	<u>63,773</u>
Total	<u>\$ 227,196</u>

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

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Voucher	<u>\$ 284,840</u>
Total	<u>\$ 284,840</u>

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2004, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$12,036,000	\$1,195,000	\$(485,000)	\$12,746,000	\$451,000
Property Tax Debt	6,916,394		(154,423)	6,761,971	331,465
Treasury Department-Claims	3,392,261		(217,490)	3,174,771	350,972
Compensated Absences	1,229,953	500,318	(190,473)	1,539,798	175,000
Claims and judgments	<u>164,490</u>	<u>28,493</u>	<u> </u>	<u>192,983</u>	<u>192,983</u>
Total	<u>\$23,739,098</u>	<u>\$1,723,811</u>	<u>\$(1,047,386)</u>	<u>\$24,415,523</u>	<u>\$1,501,420</u>

- 1. Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. LONG-TERM LIABILITIES (CONTINUED)

2. Bonds payable- The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. During the current year, the Municipality Assembly authorized a bonds issuance for approximately \$1,195,000, as described in the Note 3 (B). Bonds payable outstanding at June 30, 2004 are as follows:

<u>Type of bonds</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest Rates</u>	<u>Balance at June 30, 2004</u>
1983-Series	1-1-2005	\$ 182,000	5.00%	\$ 11,000
1985-Series	1-1-2005	125,000	5.00%	10,000
1990-Series	7-1-2004	315,000	3.26% to 8.40%	45,000
1999-Series	7-1-2018	2,630,000	5.00% to 7.81%	2,345,000
2000-Series	7-1-2026	1,760,000	5.00% to 7.00%	1,435,000
2001-Series	7-1-2010	1,300,000	5.00% to 8.00%	1,175,000
2001-Series	7-1-2017	1,070,000	5.00% to 8.00%	975,000
2002-Series	7-1-2026	135,000	5.00% to 7.00%	125,000
2002-Series	7-1-2021	475,000	5.00% to 7.00%	455,000
2002-Series	7-1-2026	1,965,000	5.00% to 7.00%	1,900,000
2002-Series	7-1-2026	2,085,000	5.00% to 7.00%	1,975,000
2004-Series	7-1-2027	1,115,000	5.00% to 6.50%	1,100,000
2004-Series	7-1-2014	1,195,000	5.00% to 6.50%	<u>1,195,000</u>
Total general obligation bonds				<u>\$ 12,746,000</u>

These bonds, except the \$1,760,000 Bonds 2000 Series, and the \$2,085,000 Bonds 2002 Series, are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$451,000	\$ 613,131
2006	415,000	766,916
2007	440,000	744,998
2008	470,000	721,121
2009	495,000	695,457
2010-2014	3,070,000	3,005,871
2015-2019	3,285,000	2,057,253
2020-2024	2,480,000	1,126,800
2025-2029	<u>1,640,000</u>	<u>221,250</u>
Total	<u>\$ 12,746,000</u>	<u>\$ 9,952,797</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

9. LONG-TERM LIABILITIES (CONTINUED)

3. **Property Tax Debt-** These amounts represent the balance owned to the Treasury Department and to the Municipal Revenue Collection Center (CRIM) at June 30, 2004 as described in Note 6.
4. **Treasury Department Debt-** These amounts represent the balance owned to the Treasury Department at June 30, 2004, for payments of claims and judgments to third parties disbursed by the Treasury Department and related to claims and judgments unfavorable outcomes or final settlements against the Municipality. The Municipality agreed with the treasury Department to reimburse to it such amount in monthly installments to be retained by the Municipal Revenue Collection Center from the monthly property tax advances.
5. **Compensated absences-** The government-wide statement of net assets includes approximately \$631,537 of accrued sick leave benefits, and approximately \$908,261 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

10. PENSION PLAN

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

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

10. PENSION PLAN (CONTINUED)

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2004 amounted to approximately \$274,037 and \$307,153, respectively.

On September 24, 1999, an amendment to Act. No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances.

Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2004, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

11. RISK MANAGEMENT

The Finance Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Finance Department Division compiles the information of all property owned and its respective market value. After evaluating this information, the Finance Department Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

12. CAPITAL ASSETS REPORTED VALUE:

The Municipality has not maintained complete and adequate records related to the Capital Assets reported in governmental activities of the government-wide financial statements and, therefore, such condition would affect the amounts of assets, net assets, and expenses of the governmental activities. The Municipality expects to compile documents and other information in the next fiscal years in order to attain complete and accurate records of its Capital Assets.

13. CONTINGENCIES

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

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$192,983 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as 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 the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

14. BEGINNING FUND BALANCES RESTATEMENT:

The beginning Fund Balance for General Fund has been restated by approximately \$60,000 to properly presents the previously reported fund balance at June 30, 2003. The restatement is mainly due to the reclassification of a liability from previously reported as current liability to long term liability, according to an amortization agreement signed with the Treasury Department of the Commonwealth of Puerto Rico.

The beginning Fund Balance for Special Revenue has been restated by approximately \$33,992 to properly presents the previously reported fund balance at June 30, 2002. The restatement is mainly due to a correction of error related to disbursement transactions posted to erroneous accounts in the accounting records.

The beginning Fund Balance for Capital Project Fund has been restated by approximately \$33,992 to properly presents the previously reported fund balance at June 30, 2003. The restatement is mainly due to a correction of error related to disbursement transactions posted to erroneous accounts in the accounting records.

The beginning Fund Balance for Debt Service Fund has been restated by approximately \$394,281 to properly presents the previously reported fund balances at June 30, 2003. The restatement is mainly due to the recognition of the amount due from CRIM related to the Final Liquidation of the fiscal year 2002-2003.

The beginning Governmental Activities Net Assets has been restated by approximately \$98,128 to properly present the previously reported net assets at June 30, 2003. The restatement is mainly due to fund balances restatements described above, and the correction of error in the property tax advance long-term debt balance.

15. SUBSEQUENT EVENTS

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2004

	<u>Budgeted Amounts</u>		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive Negative
	Original	Final		
REVENUES:				
Property taxes	\$ 2,696,133	\$ 2,842,533	\$ 2,842,589	\$ 56
Municipal license tax	1,969,858	2,574,258	2,579,025	4,767
Licenses, permits and other local taxes	1,170,649	361,249	382,567	21,318
Charges for service	47,000	32,800	33,127	327
Intergovernmental	3,963,865	4,136,365	4,161,804	25,439
Interest	75,000	106,600	143,029	36,429
Miscellaneous	<u>76,000</u>	<u>449,400</u>	<u>40,115</u>	<u>(409,285)</u>
Total revenues	<u>9,998,505</u>	<u>10,503,205</u>	<u>10,182,256</u>	<u>(320,949)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	3,929,721	4,194,240	4,162,031	32,209
Public safety	938,094	821,553	818,332	3,221
Public works	3,055,789	3,373,727	3,354,925	18,802
Health and welfare	855,305	826,053	825,801	252
Culture and recreation	801,489	866,169	860,139	6,030
Education	102,557	87,613	87,319	294
Operating transfer to other funds	<u>315,550</u>	<u>333,850</u>	<u>333,750</u>	<u>100</u>
Total expenditures, encumbrances and other financing uses	<u>9,998,505</u>	<u>10,503,205</u>	<u>10,442,297</u>	<u>60,908</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (260,041)</u>	<u>\$ (260,041)</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule				\$ 10,182,256
Differences-budget to GAAP:				
Proceed from bond issuance				1,195,000
No budgeted revenues				631,718
No budgeted transfer in				<u>194,754</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 12,203,728</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule				\$ 10,442,297
Differences-budget to GAAP:				
GAAP adjustments to expenditures				(31,774)
Prior year encumbrances recorded as current year expenditures for GAAP basis				7,395
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(120,751)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,297,167</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

NOTES TO THE BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2004

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2004 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico - Department of Education: Child and Adult Care Food Program	10.558	Not Available	\$ <u>326,567</u>
Total U.S. Department of Agriculture			<u>326,567</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program: Section 8 Housing Choice Vouchers	14.871		834,496
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioners of Municipal Affairs: Community Development Block Grant - State's Program	14.228	99-FD-51 00-FD-51 01-FD-51 02-AB-FC-51 03-AB-FC-51	<u>1,077,987</u>
Total U.S. Department of Housing and Urban Development			<u>1,912,483</u>
U.S DEPARTMENT OF JUSTICE:			
Pass-through the Commonwealth of Puerto Rico - Department of Justice: Edward Byrne Memorial	16.580	Not Available	61,068
Total U.S. Department of Justice			<u>61,068</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families:			
Community Services Block Grant	93.569	Not Available	29,609
Head Start Program	93.600	04-CH-483-22 05-CH-483-22	<u>3,327,489</u>
Total U.S. Department of Health and Human Services			<u>3,357,098</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency:			
Emergency Management Performance Grant	83.552	Not Available	10,335
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Public Assistance Grant	83.544	1247-DRPR	38,526
Hazard Mitigation Grant	83.548	1247-DRPR	<u>101,139</u>
Total U.S. Department of Homeland Security			<u>150,000</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 5,807,216</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2004

1. BASIS OF PRESENTATION:

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

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

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

Description	Special Revenue Fund Head Start	Special Revenue Fund Other Federal Grants	Other Governmental Funds	Total
Expenditures of Federal Awards per Fund	\$ 3,654,056	\$ 1,318,664	\$ 834,496	\$5,807,216
Non federal expenditures per Fund		15,519	11,616	27,135
Total expenditures per Fund	\$ 3,654,056	\$ 1,334,183	\$ 846,112	\$5,834,351



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

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

We have audited the basic financial statements of the **Municipality of Peñuelas** as of and for the year ended June 30, 2004, and have issued our report thereon dated December 20, 2004, which was unqualified at the fund financial statements level, but adverse at the government-wide financial statements level because we were unable to obtain competent evidential matter related to the Capital Assets reported in the governmental activities. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

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

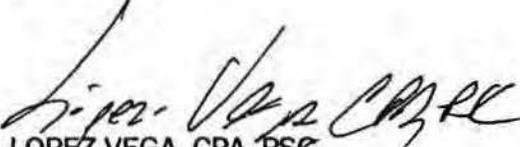
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Peñuelas's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Peñuelas's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs items **04-01** and **04-02**.

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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose reportable conditions that are also considered to be material weaknesses. However, we believe **item 04-01** of the reportable conditions described in the accompanying Schedule of Findings and Questioned Costs is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the **Municipality of Peñuelas** in a separate letter dated December 20, 2004.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 20, 2004

Stamp No. 2019446 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.





López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

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

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

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

Compliance

We have audited the compliance of the **Municipality of Peñuelas** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. The **Municipality of Peñuelas's** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Peñuelas's** management. Our responsibility is to express an opinion on the **Municipality of Peñuelas's** compliance based on our audit.

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

In our opinion, the **Municipality of Peñuelas's** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004. 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 findings and questioned costs as items, 04-03 through 04-15.

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

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality of Peñuelas's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items **04-03** through **04-15**.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees on the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weakness. However, of the reportable conditions described above we consider items **04-03** through **04-05**, **04-07** through **04-10** to be material weaknesses.



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

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the Municipality of Peñuelas in a separate letter dated March 8, 2005.

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


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 8, 2005

Stamp No. 2019447 of the Puerto Rico
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was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2004

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: **Unqualified, except for adverse for government-wide financial statements**

Internal control over financial reporting:

Material weakness identified? Yes No

Reportable conditions identified not considered to be material weaknesses? Yes None reported

Noncompliance material to financial statements noted? Yes No

Federal awards

Internal Control over major programs:

Material weakness identified? Yes No

Reportable conditions identified not considered to be material weaknesses? Yes None reported

Type of auditors' report issued on compliance for major programs: **Unqualified**

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? Yes No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
10.558	Child and Adult Care Food Program
14.228	Community Development Block Grant-State Program
14.871	Section 8 Housing Choice Voucher Program
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B programs

\$ 300,000

Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference	04-01
Requirement	Fixed\ Capital Assets and Expenditures – Subsidiary Ledger
Statement of Condition	The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.
Criteria	Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain updated property accounting records. Also, the GASB Statement No. 34 requires that all capital assets, including infrastructure, must be presented in the Statement of Net Assets and that these assets must be depreciated during its useful life.
Cause of Condition	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
Effect of Condition	The Municipality's Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.
Recommendation	We recommend that the Municipality should continue the compilation of documents to support the value, completeness and ownership of its capital assets, to comply with the requirements of the GASB Statement No. 34.
Questioned Costs	None
Management Response and Corrective Action	The Municipality Management will continue with the compilation of evidence to support the cost assigned to all of capital assets recorded in the fixed asset subsidiary ledger.

Implementation Date: June 2006

Responsible Person: Mr. Arnaldo Rivera
Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section II – Financial Statements Findings

Finding Reference	04-02
Requirement	Financial Reporting – Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds.
Criteria	Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.
Cause of Condition	The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.
Effect of Condition	The Municipality's accounting system did not provide updated and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.
Questioned Cost	None.
Management Response and Corrective Action	The Municipality's Finance Department personnel were instructed to strengthen control and procedures to assure that the accounting system will provide information regarding authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.

Implementation Date: June 2006

Responsible Person: Mr. Arnaldo Rivera
Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-03
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Financial Administration--Standard for Financial Management System Reporting
Statement of Condition	During our audit, we noted that Municipality did not maintained a set of manual accounting records for the fiscal year 2003-2004, to present properly the financial position and the results of operations of the Program. Such condition did not permit the Municipality to prepare and submit on time and accurate Voucher for Payment of Annual Contributions and Operating Statement, and not permit an audit trial of such report to the accounting records.
Criteria	<p>Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.</p> <p>The Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management, states the financial record keeping and management requirements with respect to Housing Assistance Payments Program Projects under annual contribution contracts.</p>
Cause of Condition	After the decease of the program accountant, the Municipality engaged a new program accountant who confront problems with the Housing Choice Voucher Program accounting policies and procedures.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart C, Part 85.20 (b) (2).
Recommendation	We recommended Management to instruct the program accountant to follow financial management and accounting procedures established in the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management, and the policies and procedures established in the Low Rent Housing Accounting Guide (7510.1).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-03 (continued)**

Questioned Cost None.

**Management Response
and Corrective Action** The Municipality's Management gave instructions to the program
accountant to update the accounting records in order to comply with
the Program financial management and accounting requirements.

Implementation Date: July 2005

Responsible Person: José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-04
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Allowable Costs/Cost Principles Reporting
Statement of Condition	The housing assistance payments expenditures reported in the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2004 included the housing assistance payments issued during the fiscal year 2003-2004 on behalf of portability participants administered by the Municipality. Also, the administrative fee income related to portability participants administered by the Municipality was not reported in the operating receipts section of the HUD-52681, Vouchers for Payment of Annual Contributions and Operating Statement for the year ended June 30, 2004.
Criteria	OMB Circular A-87, Attachment C, states that to be allowable under Federal awards, costs must be net of all applicable credits, such as receipt or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Code of Federal Regulation 24, Subpart C, Section 85.20 (b) (1), require that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub-grant. Also, Code of Federal Regulation 24, Subpart C, Section 85.20 (b) (2) states that the grantee must maintain records, which adequately identify the source and application of funds, provided for financially assisted activities.
Cause of Condition	The housing assistance payments issued during the fiscal year 2003-2004 on behalf of portability participants administered by the Municipality was recorded in the Housing Assistance Payment General Ledger expenditures account (4715). Also, the administrative fee income related to portability participants was not properly recorded in the General Ledger.
Effect of Condition	The Municipality submitted a Year-End Settlement Statement report with overstated expenditures and understated cash receipts, affecting the year end settlement results and the operating reserve balance.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-04 (continued)**

Recommendation We recommended to the Municipality Management to instruct the program accountant to follow financial management procedures established in the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management.

Questioned Cost Approximately \$10,596

Management Response and Corrective Action The Municipality's Management gave instructions to program accountant to modify the general ledger accounts and to modify the accounting procedures in order to properly record the portability transactions (as illustrated in the Voucher Program Guidebook-Housing Choice (7420.10G), Chapter 20, Financial Management) to comply with the Program financial management and accounting requirements. Also, the accountant was instructed to revise past transactions and, to post in the books any accounting adjustment necessary to properly present the financial position and the results of operations of the Program.

Implementation Date: July 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-05
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	We performance the Cash Management Test and after our procedures, we found that the Municipality maintained during the current fiscal year average cash balance in books of approximately \$274,973. At June 30, 2004, the cash balance in book was \$292,662; \$34,482 of these funds was from HUD overpayment during the fiscal year 2003-04 as determined in the year-end settlement; \$27,499 was from operating reserve at June 30, 2004, as determined in the year-end settlement; and the remaining \$230,681 was not identified by us with respects to its origin.
Criteria	OMB Common Rules, Subpart C, Section 85.20 (b) (7), which requires a cash management system, in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee.
Cause of Condition	The condition may be caused by cumulative effect of accounting errors in the past years and current years; errors such as reporting portability administered by the Municipality as HAP expenditures in the year-end settlements, non recognition of portability administrative fee earned in the year-end settlements, non recognition of recoveries from tenants and owners in the year-end settlements, non recognition of interest earned on operating reserve in the year-end settlement, etc.
Effect of Condition	The Municipality did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).
Recommendation	We recommend to the Municipality's Management to instruct the program accountant to review the accounting records and related transactions supporting documents for the current and past years in order to identify the cash balance respects to its origin, and later, to make any necessary adjusting journal entries to correct accounting records.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

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

**Management Response
and Corrective Action**

The Municipality's Management gave instructions to program accountant to revise past cash transactions and, to post in the books any accounting adjustment necessary to properly present the financial position and the results of operations of the Program. Particular attention will be directed to evaluate the portability move-in transactions, interest income transactions, cancelled checks, and recoveries from tenants and owners as part of the operating reserve analysis.

Implementation Date: July 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-06
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Housing Quality Standards Inspections
Statement of Condition	The Municipality (PHA) did not perform an adequate number of quality control re-inspections during the fiscal year 2003-2004. The Municipality maintained a universe of approximately one hundred sixty three (163) housing vouchers, but only two (2) quality control re-inspections were conducted by the program staff, instead of the minimum sample size required by the Program regulations.
Criteria	<p>Code of Federal Regulations 24, Subpart I, Section 982.405 (b) states that the PHA must inspect the unit leased to a family at least annually to determine if the unit meets Housing Quality Standards (HQS) and the PHA must conduct supervisory quality control re-inspections to determine if the work documented in the files conform to program requirements.</p> <p>Code of Federal Regulations 24, Subpart A, 985.2 and the Housing Choice Voucher Guidebook, number 7420.10G, Chapter ten (10), include a guide to determine the minimum size of the PHA's quality control sample.</p>
Cause of Condition	The Municipality's controls and procedures failed to assure that the minimum quality controls re-inspections were conducted during the fiscal year 2003-2004.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sections 982.405 (b) and 985.2 and with the Housing Choice Voucher Guidebook, number 7420.10G, Chapter ten (10).
Recommendation	We recommend the Municipality's Management to instruct the program staffs to select for inspection at least the minimum sample size of quality control re-inspections as required by the federal regulations.
Questioned Costs	None.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 04-06 (continued)

**Management Response
and Corrective Action** The Municipality's Management gave instructions to the program
staffs to implement immediate corrective actions to perform the
minimum quality control re-inspections during the fiscal year 2004-
2005..

Implementation Date: April 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-07
Program	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Reasonable Rent
Statement of Condition	The determination of reasonable rent (reasonable rent certification) was not duly documented. We examined a sample of fifteen (15) participant's files and observed that in three (3) participants admitted to the program during the fiscal year 2003-2004, the certification of reasonable rent did not include the comparable rent with other similar units.
Criteria	Code of Federal Regulations 24, Section 982.507 (a) (1) states that the PHA may not approve a lease until the PHA determines that the initial rent to owner is reasonable rent. Code of Federal Regulations 24, Section 982.507 (b) states that the PHA must determine whether the rent to owner is a reasonable rent in comparison to rent for other comparable unassisted units.
Cause of Condition	The Federal Program Department did not maintain adequate documentation to support the basis for the determination that the rent paid to the owner is reasonable.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Section 982.507 (a) (1) and 982.507 (b).
Recommendation	We recommend that the Federal Program Department establish controls to assure appropriate documentation of the determination of reasonable rent is maintained in participant's files.
Questioned Costs	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-07 (continued)**

Management Response
and Corrective Action

The Municipality's Management gave instructions to the program staffs to document appropriately the reasonable rent determination when new participants were admitted to the Program, or in cases of change of units or rent increase.

Implementation Date: April 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-08
Program	Section 8 Housing Choice Vouchers Program CFDA (14.871) U.S. Department of Housing and Urban Development
Requirement	Special Test – Utility Allowance Schedule
Statement of Condition	The Municipality did not maintain and up-to-date utility allowance schedule for the audit period ending June 30, 2004. There is no evidence of the last time that and Utility Allowance Schedule was actualized.
Criteria	Code of Federal Regulations, 24 CFR Section 982.517 states that the Municipality must maintain an up-to-date utility allowance schedule. The Municipality must review utility rate data for each utility category each year and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
Cause of Condition	The Municipality did not follow the procedures established to review utility rate data each year.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations, 24 CFR Section 982.517.
Recommendation	The Municipality should evaluate utility allowance rate each year as established in the federal regulations.
Questioned Costs	None.
Management Response and Corrective Action	The Municipality's Management had difficulty in implementing procedures to comply with this finding due to the lack of information to adjust the utility schedule. Due to the high cost of consulting services, the Municipality will communicate with other municipalities that have the same problem to establish an agreement to contract a consultant with experience in the preparation of this schedule.

Implementation Date: July 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-09
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Financial Administration-Standard for Financial Management System Reporting
Statement of Condition	During our audit we noted that for the fiscal year 2003-2004, the Municipality did not record in its manual accounting records the transactions related to Community Development Block Grant - State's Program. Such condition did not permit the Municipality to prepare and submit on time and accurate quarterly reports required by the pass-through grantor, and not permit an audit trial of such reports to the accounting records.
Criteria	Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirement must be available for Federal inspection and must: (i) be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions; (ii) ensure that the funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of state and local governments.
Cause of Condition	The Municipality did not maintain adequate controls procedures and actualized and maintain accurate manual accounting records to assure the accountability of all Federal transactions in accordance with Federal regulations.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-09 (continued)**

Recommendation We recommend that the Municipality should request technical support to the Office of the Commissioner of Municipal Affairs (OCAM) to train the program accountant in order to actualize and to maintain an accurate set of manual accounting records.

Questioned Costs None

Management Response and Corrective Action The Municipality's Management will request technical support to the Office of the Commissioner of Municipal Affairs (OCAM) to train the program accountant in order to actualize and to maintain an accurate set of manual accounting records.

Implementation Date: April 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-10
Program	Community Development Block Grant - State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State - Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Equipment and Real Property Management
Statement of Condition	Section II - Financial Statements Findings - Finding Reference 04-01

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-11
Program	Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of the Commissioner of Municipal Affairs (OCAM)
Requirement	Reporting
Statement of Condition	<p>During our examination of the program’s Financial Quarterly Reports, we noted the following situations:</p> <ul style="list-style-type: none">a. The Municipality did not maintain evidence to demonstrate if the Financial Quarterly Reports were submitted on a timely basis to the Pass-through Grantor (OCAM).b. The Financial Quarterly Reports for the period ended 6/30/04 was not available for our examination.c. The Financial Quarterly Reports for the periods ended 09/30/03, 12/31/03 and 3/31/04 could not be traced to the general ledgers because the Municipality did not maintain an actualized and accurate set of manual accounting records.
Criteria	<p>Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. Also, the Grant Agreement provisions have established that the Municipality should submit all of the reports required by the Pass-through Grantor.</p>
Cause of Condition	<p>The Municipality did not maintain adequate controls procedures and actualized and maintain accurate manual accounting records to assure the accountability of all Federal transactions in accordance with Federal regulations. Also, the Municipality’s record retention control and procedures fail to assure that those reports were maintained safeguarded and available to be examined by us during the application of planned audit procedures.</p>
Effect of Condition	<p>The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1), and the Grant Agreement provisions.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-11 (continued)**

Recommendation We recommend that the Municipality should request technical support to the Office of the Commissioner of Municipal Affairs (OCAM) to train the program accountant in order to actualize and to maintain an accurate set of manual accounting records. Also, we recommend that the Municipality should implement procedures in order to assure that all financial and programmatic records, supporting documents, statistical records, and other records be adequately safeguarded.

Questioned Costs None

Management Response and Corrective Action The Municipality's Management gave instructions to the program staffs to strengthen recordkeeping procedures in order to assure that all reports and other documents were available for audit purposes. Also the Municipality's Management will request technical support to the Office of the Commissioner of Municipal Affairs (OCAM) to train the program accountant in order to actualize and to maintain an accurate set of manual accounting records.

Implementation Date: April 2005

Responsible Person: Mr. José L. Camacho
Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-12
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico-Administration for Care and Integral Development of Childhood (ACUDEN)
Requirement	Allowable Costs/Cost Principles
Statement of Condition	During the fiscal year 2003-2004, the program made a lease contract with the Puerto Rico Industrial Development Company (PRIDCO) to rent a local that will be the new administrative office of Head Start Program. The lease amount is of \$4,236.00 by month, for the first five (5) years. As of June 30 2004, the program had paid the amount \$50,835.00 and still has not yet moved to the new facilities.
Criteria	OMB Circular A-87, Attachment C, states that to be allowable under Federal awards, costs must meet the some general criteria, including the following: (a) be necessary and reasonable for proper and efficient performance and administration of Federal awards.
Cause of Condition	The Agency did not obtain the approval of funds in the “Program Improvement” proposal for the fiscal year 2002-2003 for the reason that the Administration for Children’s and Families of the Department of Health and Human Services, Region II- New York, the program’s grantor, did not assigned funds for that activity in the Region.
Effect of Condition	The Municipality is not in compliance with OMB Circular A-87.
Recommendation	We recommend to the Municipality’s Management to request external funds or to assign local funds to realize promptly the improvements to the new facilities to relocate the administrative office of the Head Start Program.
Questioned Costs	\$50,835

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-12 (continued)**

**Management Response
and Corrective Action**

The Municipality Management submitted a new "Program Improvement" proposal to the Administration for Children's and Families of the Department of Health and Human Services, Region II-New York, and they are waiting for a response from the Agency.

Implementation Date: May 2004

Responsible Person: Mrs. Wanda B. Jaime Rivera
Head Start Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-13
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico-Administration for Care and Integral Development of Childhood (ACUDEN)
Requirement	Cash Management
Statement of Condition	During our Cash Management test, we noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$293,254.39 was maintained during the fiscal year ended June 30, 2004.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (7) states that the Municipality must maintain procedures for minimizing the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by grantees and sub grantees whenever advance payment procedures are used.
Cause of Condition	The cash advance procedures established by the Administration for Care and Integral Development of Childhood-(ACUDEN) through grant agreement provide for only an advance per month.
Effect of Condition	The Municipality requested funds in excess of immediate needs and for that reason it's not in compliance with Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to continue strengthen it's procedures to minimize the time elapsed between the transfer of funds from the Administration for Care and Integral Development of Childhood-(ACUDEN) and the disbursements made by the Municipality.
Questioned Costs	None
Management Response and Corrective Action	The Municipality's Management request to the Administration for Care and Integral Development of Childhood-(ACUDEN) to assess the existing cash management procedures in order to modify such procedures to comply with the cash management requirements.

Implementation Date: March 2006

Responsible Person: Mrs. Wanda B. Jaime Rivera
Head Start Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	04-14
Program	Head Start Program (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico – Administration for Care and Integral Development of Childhood (ACUDEN)
Requirement	Matching, Level of Effort, Earmarking – Administrative Cost Limits
Statement of Condition	The Accounting System maintained by the Head Start Program financial activities did not provide for the classification of financial transactions between administration and programmatic costs. Alternate procedures were used by the Program staff at the end of the program fiscal year to compute compliance with the fifteen (15%) administrative costs limit.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.20 (a) (2) states that the sub grantees must maintain fiscal controls and accounting procedures sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restriction and prohibitions of applicable statutes.
Cause of Condition	The Municipality did not maintain adequate internal controls to assure the accountability of all transactions in accordance with Federal Regulations.
Effect of Condition	Such condition may cause Municipality's non-compliance with certain compliance requirements like: allowable costs, activities allowed and unallowed; and earmarking.
Recommendation	We recommend management to modify the Accounting System chart of accounts to create separate accounts for administrative and programmatic expenditures. Also, cost with dual benefits (administrative and programmatic) should be identified and allocated appropriately using a cost-benefit proportion.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **04-14 (continued)**

**Management Response
and Corrective Action**

The Municipality's Management will modify the Accounting System chart of accounts to create separate accounts for administrative and programmatic expenditures.

Implementation Date: March 2006

Responsible Person: Mrs. Wanda B. Jaime Rivera
Head Start Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	04-15
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico-Administration for Care and Integral Development of Childhood (ACUDEN)
Requirement	Procurement and Suspension and Debarment
Statement of Condition	During our contract provisions test, we identified the following conditions: (a) Four (4) contracts did not include provisions for contractual legal remedies when contract violates contract term, and did not provide such sanctions and penalties; (b) four (4) contracts did not include provisions for termination grantee for default.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.36 (l) (1-13), states that sub-grantee's contract must contain provisions described in paragraph (l) of this section.
Cause of Condition	The Municipality did not maintain appropriate procurement standard procedures in order to assure that a contractor complies with some requirements.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Section 92.36, (l) (1-13).
Recommendation	We recommend management to prepare a sample contract model, which include all contract provisions required by Federal statutes, Executive Orders, and implementing regulations.
Questioned Costs	None
Management Response and Corrective Action	The Municipality's Management instruct the Municipal Administrative Department staff to includes in each executed contract, all contract provisions required by Federal statutes, Executive Orders, and implementing regulations.

Implementation Date: April 2005

Responsible Person: Mrs. Wanda B. Jaime Rivera
Head Start Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
03-05	14.871	<u>Fifteen (15) Housing Voucher Program cancelled checks were not available for our examination.</u> Full corrective action was taken.
03-06	14.871	<u>The Municipality maintained during the current fiscal year average cash balance in books of approximately \$262,060. At June 30, 2003, the cash balance in book was \$258,168, \$25,855 of these funds were from operating reserve at June 30, 2003, as determined in the year-end settlement; and the remaining \$232,313 was not identified by us with respects to its origin. Also, an underpayment of \$16,736 was determined by HUD during the fiscal year 2002-03 year-end settlement.</u> No corrective action was taken. See corrective action planned on Finding 04-05.
03-07	14.871	<u>In six (6) cases the Release of Information\Privacy Act Notice form was not provided by signature of head of household. In three (3) cases the Release of Information\Privacy Act Notice form was not provided by signature of another member of the family with eighteen years or older.</u> Full corrective action was taken.
03-08	14.871	<u>We found that the PHA did not select the participant from the top of the waiting list according to the PHA's applicant selection policies.</u> Full corrective action was taken.
03-09	14.871	<u>On five (5) new participant files the certification of reasonable rent did not include the comparable rent with other similar units. On four (4) participant files the determination of reasonable rent did not include comparable unassisted units in an increase of the rent to owner during fiscal year 2002-2003.</u> No corrective action was taken. See corrective action planned on Finding 04-07.
03-10	14.871	<u>The Municipality did not maintain and up-to-date utility allowance schedule for the audit period ending June 30, 2003. There is no evidence of the last time that and Utility Allowance Schedule was</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<u>actualized.</u>
		No corrective action was taken. See corrective action planned on Finding 04-08.
03-11	14.228	<u>During our audit we noted that the Municipality did not maintain, for the Community Development Block Grant – State’s Program, a reliable set of accounting records that present the financial position of the program, the results of operations and changes in fund balance.</u>
		No corrective action was taken. See corrective action planned on Finding 04-09.
03-12	14.228	<u>Three (3) CDBG State Program disbursement vouchers were not available for examination. In one (1) CDBG State Program disbursement voucher, the purchase order was issued after the receiving of services. One (1) CDBG State Program cancelled check was not available for our examination.</u>
		Full corrective action was taken.
03-13	14.228	<u>The Municipality requested funds that were not disbursed on a reasonable lapse of time.</u>
		Full corrective action was taken.
03-14	14.228	<u>The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.</u>
		No corrective action was taken. See corrective action planned on Finding 04-01.
03-15	14.228	<u>The Financial Quarterly Reports for the quarters ended during the fiscal year 2002-2003 were not available for our examination. Therefore, we could not obtain evidence to assure us that the Financial Quarterly Reports were submitted timely to OCAM and prepared in accordance with the required accounting basis.</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		No corrective action was taken. See corrective action planned on Finding 04-11.
03-16	93.600	<u>In four (4) Head Start disbursement vouchers, the purchase order, and the requisition were issued after the receiving of services. Six (6) Head Start disbursement vouchers did not include evidence of the quotation's analysis in the procurement process.</u> Full corrective action was taken.
03-17	93.600	<u>The Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$241,414 was maintained during the fiscal year ended June 30, 2003.</u> No corrective action was taken. See corrective action planned on Finding 04-13.
03-18	93.600	<u>Four (4) contracts did not include provisions for contractual legal remedies when contract violates contract term, and did not provide such sanctions and penalties. Three (3) contracts did not include provisions for termination grantee for default.</u> No corrective action was taken. See corrective action planned on Finding 04-15.
02-05	14.871	<u>The Municipality should periodically compare actual program cash requirements to the funds advanced from U. S. Treasury Department and prepare and submit a revised requisition to reduce monthly advances.</u> No corrective action was taken. See corrective action planned on Finding 04-05.
02-06	14.871	<u>The Municipality should establish the following procedures: provide an application form to be filled by the participant and sign by all members of the family who are at least 18 years old; provide a Federal-Prescribed General Release Form for employment information and a privacy act notice to be signed by all members of the family who are at least 18 years old; implement internal control procedures to assure that the participant's files include all documentation required by federal agencies; establish monitoring procedures to assure that HAP's are</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS – (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<u>duly computed as required by the Federal Regulations.</u>
		Full corrective action was taken.
02-10	14.871	<u>The Municipality should evaluate utility allowance rate each year as established in the federal regulations.</u>
		No corrective action was taken. See corrective action planned on Finding 04-08.
02-12	14.871	<u>The Municipality should explain in the file the reason for selection of participants which was not included in the waiting list. The Management should comply with all requirements of the program regulation and administrative plan.</u>
		Full corrective action was taken.
02-13	14.871	<u>The Municipality should implement controls to assure appropriate documentation of the determination of reasonable rent is maintained in participants file.</u>
		No corrective action was taken. See corrective action planned on Finding 04-07.
02-14	93.600	<u>The Municipality should strength it's procedures to minimize the time elapsed between the transfer of funds from the Administration for Children and Families and the disbursements made by the Municipality.</u>
		No corrective action was taken. See corrective action planned on Finding 04-13.
01-06	14.855 14.857	<u>Eligibility Test</u>
		The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.
01-12	14.855 14.857	<u>Special Test – Reasonable Rent</u>
		The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS - (CONTINUED)

YEAR ENDED JUNE 30, 2004

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		submitted to the Federal clearinghouse.
00-III-02	14.228	<u>Allowable Cost\Cost Principles</u>
		The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.