

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE PONCE

AUDITORIA 2000-01

30 DE JUNIO DE 2001

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MUNICIPALITY OF PONCE, PUERTO RICO

Reports on Compliance and Internal Control in
Accordance with Government Auditing Standards
and the Requirements of OMB Circular A-133 and
the Schedule of Expenditures of Federal Awards for
the Year Ended June 30, 2001

MUNICIPALITY OF PONCE, PUERTO RICO

REPORTS ON COMPLIANCE AND INTERNAL CONTROL IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS AND THE REQUIREMENTS OF OMB CIRCULAR A-133 AND THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2001

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MUNICIPALITY OF PONCE, PUERTO RICO

REPORTS ON COMPLIANCE AND INTERNAL CONTROL IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS AND THE REQUIREMENTS OF OMB CIRCULAR A-133 AND THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2001

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MUNICIPALITY OF PONCE, PUERTO RICO

PART I

INDEPENDENT AUDITORS' REPORT



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

Honorable Mayor and Members of the Municipal Assembly
Municipality of Ponce
Ponce, Puerto Rico

We have audited the general purpose financial statements of the Municipality of Ponce, Puerto Rico (the "Municipality") as of and for the year ended June 30, 2001 and have issued our report thereon dated December 21, 2001 which was qualified for the effects of the adjustments, if any, as might have been determined to be necessary had we been able to audit the general fixed assets account group and had the auditors of Port of Ponce been able to obtain sufficient evidence regarding the balances carried forward for property, plant and equipment, and accumulated depreciation for the years prior to July 1, 1987, and any related amount of depreciation expense for the year ended June, 30, 2001. Except as previously noted, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, applicable to the Municipality for only those matters relating to compliance of the funds and account groups of the Municipality included within the scope of our audit as described in our report referred to above on the general purpose financial statements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings and Questioned Costs as items 01-01 through 01-05, 01-10 and 01-11. Our testing of compliance did not extend to tests of compliance with laws, regulations, contracts and grants for the discretely presented component units whose financial statements were audited by other auditors.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting, applicable only to the internal control over financial reporting relating to the primary government of the Municipality included within the scope of our audit as described in our report referred to above on the general purpose financial statements, in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Accordingly, our consideration did not extend to the internal control over financial reporting relating to the discretely presented component units whose financial statements were audited by other auditors. However, we noted certain matters involving the internal control over financial reporting of the primary government and its operations 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 financial reporting that, in our judgment, could adversely affect the Municipality's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs, included in Part II.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable condition and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 01-01, 01-03, 01-04, 01-05, 01-06, 01-12 and 01-13 to be material weaknesses.

This report is intended solely for the information and use of the Municipal Assembly, management, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

White & Touche LLP

December 21, 2001

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARDS PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Honorable Mayor and Members of the Municipal Assembly
Municipality of Ponce
Ponce, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Ponce, Puerto Rico (the "Municipality"), with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2001. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

As described in the table below, and in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with the requirements regarding activities allowed or unallowed; allowable costs/cost principles; cash management; Davis Bacon Act; eligibility; equipment and real property management; matching, level of effort and earmarking; period of availability of Federal funds; program income; reporting; subrecipient monitoring, and applicable special tests and provisions that are applicable to its Community Development Block Grant, HUD Disaster Recovery Initiative, Section 8 Tenant-Based Cluster, Section 8 Project-Based Cluster, Public Safety Partnership and Community Policing Grant, Welfare-to-Work, Workforce Investment Act, Public Assistance Grants, Administration for Children, Youth and Families ("Head Start") and HIV Cluster - HIV Emergency Relief Project and Formula Grants ("Ryan White"). Compliance with such requirements is necessary, in our opinion, for the Municipality, to comply with requirements applicable to these programs.

<u>Requirements</u>	<u>Items Number - SA -</u>	<u>Programs</u>
Activities allowed or unallowed	SA-01-02, 01-11	Community Development Block Grant, Section 8 Tenant-Based Cluster
Allowable costs/cost principles	SA-01-02, 01-11	Community Development Block Grant, Section 8 Tenant-Based Cluster
Cash management	SA-01-01, 01-05, 01-10, 01-14, 01-16, 01-19, 01-20, 01-23	Community Development Block Grant, Section 8 - Tenant-Based Cluster, Section 8 - Project-Based Cluster, HUD Disaster Recovery Initiative, Welfare to Work, Workforce Investment Act and Head Start
Davis Bacon Act	SA-01-25	Head Start
Eligibility	SA-01-13, 01-15	Section 8 - Tenant-Based Cluster, Section 8 - Project-Based Cluster
Equipment and real property management	SA-01-08, 01-12	Community Development Block Grant, Section 8 - Tenant-Based Cluster
Matching, level of effort and earmarking	SA-01-29	Public Safety Partnership and Community Policing Grant
Period of availability of Federal Funds	SA-01-17, 01-28	HUD Disaster Recovery Initiative, Ryan White
Program - income	SA-01-07	Community Development Block Grant
Reporting	SA-01-01, 01-04, 01-18, 01-21, 01-26, 01-30, 01-31	Community Development Block Grant, Section 8 - Tenant-Based Cluster, Section 8 - Project-Based Cluster, HUD Disaster Recovery Initiative, Welfare to Work, Workforce Investment Act, Head Start Ryan White and Public Assistance Grant
Subrecipient monitoring	SA-01-27	Ryan White
Special tests and provisions	SA-01-22, 01-24	Head Start
Noncompliance with pledge requirement	SA-01-33	Loan Guarantee Assistance

In our opinion, except for the noncompliance described in the preceding paragraph and accompanying table, the Municipality, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001. The results of our auditing procedures also disclosed other 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 SA-01-03, 01-06, 01-09 and 01-32.

Internal Control Over Compliance

The management of the Municipality, is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contract, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test 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'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 SA-01-01 through 01-31.

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 in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items SA-01-01, 01-02, 01-04, 01-05, 01-07, 01-08, 01-10 through 01-31, and 01-34 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the general purpose financial statements of the Municipality as of and for the year ended June 30, 2001, and have issued our report thereon dated December 21, 2001, which was qualified for our ability to audit the financial activities of the general fixed assets account group and for the ability of the auditors of the Port of Ponce to obtain sufficient evidence regarding the balances carried forward for property, plant and equipment, and accumulated depreciation for the years prior to July 1, 1987, and any related amount of depreciation expense for the year ended June 30, 2001. The report also contained one explanatory paragraph. Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the general-purpose financial statements. This schedule is the responsibility of management of the Municipality. Such information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the general purpose financial statements taken as a whole.

This report is intended solely for the information and use of the Municipal Assembly, management, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

December 21, 2001

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MUNICIPALITY OF PONCE, PUERTO RICO

PART II

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

1. Summary of Auditors' Results

We have audited the general purpose financial statements of the Municipality of Ponce, Puerto Rico as of and for the year ended June 30, 2001, and have issued our report thereon dated December 21, 2001 which was qualified for the effects the adjustments, if any, as might have been determined to be necessary had we been able to audit the general fixed assets account group and had the auditors of the Port of Ponce been able to obtain sufficient evidence regarding the balances carried forward for property, plant and equipment, and accumulated depreciation for the years prior to July 1, 1987, and any related amount of depreciation expense for the year ended June, 30, 2001. Except as previously noted, we conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the requirements of the *U.S. Office of Management and Budget (OMB) Circular A-133*. The results of our audit are as follows:

Financial Statements:

- Type of auditor's report issued on the general purpose financial statements: Qualified Opinion
- Reportable conditions in internal control over financial reporting were identified, some of which are considered to be material weaknesses.
- Instances of noncompliance considered material to the financial statements were disclosed by the audit.

Federal Awards:

- Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, some of which are considered to be material weaknesses.
- The independent auditor's report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
- The audit disclosed findings required to be reported by OMB Circular A-133.

- Major Programs:

<u>Funding Source</u>	<u>Program</u>	<u>CFDA No.</u>
U.S. Department of Housing	Community Development Block Grant	14.218
U.S. Department of Housing	HUD Disaster Recovery Initiative	14.218
U.S. Department of Housing	Section 8 – Tenant-Based Cluster:	
U.S. Department of Housing	Section 8 Rental Voucher Program	14.855
	Section 8 Rental Certificate Program	14.857
U.S. Department of Housing	Section 8 – Project-Based Cluster:	
	Lower Income Housing Assistance Program -	
	Section 8 Moderate Rehabilitation I	14.856
	Lower Income Housing Assistance Program -	
	Section 8 Moderate Rehabilitation II	14.856
U.S. Department of Labor	Welfare to Work	17.253
U.S. Department of Labor	Workforce Investment Act	17.255
U.S. Department of Health and Human Services	Administration for Children, Youth and Families (“Head Start”)	93.600
U.S. Department of Health and Human Services	HIV Cluster: HIV Emergency Relief Project and Formula Grants	93.914

- A threshold of \$1,289,365 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
- The Municipality did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

1. Introduction

The findings and recommendations as defined in Parts IV and V which are summarized in the schedule below, have been reviewed with representatives of the Municipality. In the title of each finding is a parenthetical disclosure indicating the first year that the finding was reported, and the finding number from the previous year audit report. The corrective action plans and responses to the findings and recommendations have been provided by the Municipality's representatives and reflect plans and responses as of March 19, 2002 and are included in Part VIII. These responses and corrective action plans were delivered to us after completion of our field work and, accordingly, our procedures with respect to such corrective action plans consisted of reading the Municipality's response and including them within the body of the findings. Although the responses may indicate that the supporting documentation is available for examination, the finding is not eliminated because such evidence was found after we concluded the field work.

The findings and recommendations often refer to the provisions of various authoritative documents, laws and regulations. To avoid repetition, following are the authoritative documents with their respective titles and purposes, quoted in the findings and recommendations:

1. **"Single Audit Act Amendments of 1996"** - The Single Audit Act Amendments of 1996, Public Law 104-156, enacted on July 5, 1996, by the Senate and House of Representatives of the United States of America in Congress. The Act was established to a) promote sound financial management, including effective internal controls, with respect to Federal awards administered by non-Federal entities; b) establish uniform requirements for audits of Federal awards administered by non-Federal entities; c) promote the efficient and effective use of audit resources; d) reduce burdens on State and local governments, Indian tribes, and nonprofit organizations; and e) ensure that Federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to chapter 75 of title 31, United States Code (as amended by this Act).
2. **"OMB Circular A-133"** - Circular Letter A-133 issued by the Executive Office of the President, Office of Management and Budget, titled "Audits of States, Local Governments, and Non-Profit Organizations" dated June 24, 1998. This Circular Letter establishes the audit requirements for States, Local governments and Non-Profit Organizations that receive Federal aid, and defines Federal responsibilities for implementing and monitoring those requirements. It sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards.
3. **"OMB Circular A-87"** - Circular Letter A-87 issued by the Executive Office of the President, Office of Management and Budget, titled "Cost Principles for State, Local and Tribal Governments," dated May 4, 1995. This Circular Letter establishes the principles for determining the allowable costs of programs administered by State, Local, and federally recognized Indian tribal governments under grants from and contracts with the Federal government.

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

4. **“OMB Circular A-102”** - Circular Letter A-102, (Revised), issued by the Executive Office of the President, Office of Management and Budget, titled “Grants and Cooperative Agreements with State and Local Governments,” dated March 3, 1988. This Circular Letter establishes consistency and uniformity among Federal agencies in the management of grants and cooperative agreements with State, Local, and federally recognized Indian tribal governments.
5. **“CFR”** - This is the “Code of Federal Regulations” issued by the Federal Government. The CFR is a codification of the general and permanent rules published by the Federal Government. The Code is divided into 50 titles that represent broad areas subject to Federal regulation. Each title is divided into chapters that usually bear the name of the issuing agency, and is further subdivided into parts covering specific regulatory areas.
6. **“Common Rule”** - The Common Rule refers to the “Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments” which establishes uniform administrative rules for Federal grants and cooperative agreements and subawards to State, local, and Indian Tribal governments.
7. **“Basic Standards”** - “Revised Regulation on Basic Standards for the Municipalities of Puerto Rico” approved by the Office of the Commissioner of Municipal Affairs. The Basic Standards were created under Article 19.011 of Law 81, enacted on August 30, 1991, “Autonomous Municipalities Law”. It establishes the rules and operational standards applicable to the municipalities in relation to the accountability of funds, property and other financial and fiscal matters administered by the municipalities of Puerto Rico. Its main purpose is to allow for the efficient use and administration of the municipal operations.
8. **“Municipalities Law”** - The “Autonomous Municipalities Law”, Law 81 of August 30, 1991, as amended, was enacted to establish standard rules and regulations regarding the creation, organization, administration and functions of the municipal governments in Puerto Rico. It establishes the main guidelines and requirements that governs all the municipal functions and activities.

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

Questioned Costs:

The audit of compliance with laws and regulations, and the audit of the general purpose financial statements of the Municipality resulted in the identification of questioned costs totaling \$426,449 for the year ended June 30, 2001. For those instances where costs were questioned, the specific cost has been identified in the findings reported in the following pages. On pages 14 to 16 we have included those questioned cost in the summarized information in the table titled Schedule of Findings and Questioned Costs.

The Schedule of Findings and Questioned Costs presented in Part II, as listed in the table of contents, includes items arising from the Single Audit for the year ended June 30, 2001. Items that arose during the previous Single Audit that have yet to be resolved are included in Part III of this document. Questioned costs noted in the reports of federal auditors and proposed, or pending sanctions arising from programmatic reviews by federal agencies, if any, were reviewed to determine the nature of the item and its current status. This information was considered during the development of the current year's audit procedures. The final resolution of the items arising from other audits and reviews, as well as disposition of the questioned costs included in Part II, "Schedule of Findings and Questioned Costs," as listed in the table of contents, rests with the federal grantor agencies.

Reportable Conditions:

The findings listed on pages 24 through 100 have been reported in accordance with the requirements of Government Auditing Standards, issued by the Comptroller General of the United States and the Statements on Auditing Standards 60 and 74, issued by the Auditing Standards Board of the American Institute of Certified Public Accountants. These standards require the communication of all reportable conditions regarding the entity's internal controls.

Reportable conditions are those matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control structure, which could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements and in reports applicable to its federal financial assistance programs. Such deficiencies may involve aspects of the internal control structure elements of (a) control environment; (b) the accounting system; or (c) control procedures.

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

2. Findings Related to the Financial Statements

<u>Reportable Condition/Noncompliance</u>	<u>Questioned Costs</u>	<u>Program and CFDA No.</u>
<u>Budgeting</u>		
01- 1 Operating deficit of general fund	N/A	N/A
01- 2 Expenditures quarterly reports not submitted	N/A	N/A
01- 3 Estimates of expenditures not submitted	N/A	N/A
01- 4 Lack of supporting documentation for budgeted revenue accounts	N/A	N/A
<u>Accounting and Finance Department</u>		
01- 5 Inadequate accounting practices and policies	N/A	N/A
01- 6 Inadequate accounting for interfund transactions	N/A	N/A
01- 7 Inactive and unnecessary funds and accounts are not closed	N/A	N/A
01- 8 Checks outstanding in excess of six months	N/A	Section 8 (14.855), (14.857), Workforce Investment Act (17.255), Head Start (93.600)
01- 9 Bank reconciliations not prepared on a timely basis	N/A	Section 8 (14.855), (14.856)
01- 10 Untimely contract of external auditors	N/A	N/A
<u>Purchases, Payables and Payments</u>		
01- 11 Purchase orders prepared after service was received	N/A	N/A
<u>Property Management</u>		
01- 12 Inadequate controls and accounting practices over the fixed assets subsidiary ledger	N/A	N/A
01- 13 Lack of property physical inventory	N/A	N/A

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

3. Findings and Questioned Costs for Federal Awards

	<u>Reportable Condition/Noncompliance</u>	<u>Known Questioned Costs</u>	<u>Likely Questioned Costs</u>	<u>CFDA No.</u>
<u>Finding Related to Federal Programs That Have a Separate Accounting Department and Administrative Unit</u>				
SA 01- 1	Lack of reconciliation procedures	N/A	N/A	All Federal Programs
<u>Community Development Block Grant</u>				
SA 01- 2	Amounts due from general fund	N/A	N/A	14.218
SA 01- 3	Unsupported difference in bank reconciliation	N/A	N/A	14.218
SA 01- 4	Financial summary report is inaccurate	N/A	N/A	14.218
SA 01- 5	Inadequate cash management procedures	\$ 1,782	N/A	14.218
SA 01- 6	Unliquidated obligations of closed program years not credited to federal program	23,491	N/A	14.218
SA 01- 7	Failure to monitor program-income producing activities	N/A	\$ 10,000	14.218
SA 01- 8	Inadequate property management procedures	N/A	N/A	14.218
SA 01- 9	Interest earned not remitted to federal grantor	9,154	N/A	14.218
<u>Section 8 - Tenant-Based Cluster</u>				
SA 01- 10	Inadequate cash management procedures	51,866	N/A	14.855 and 14.857
SA 01- 11	Amounts due from general fund	N/A	N/A	14.855 and 14.857
SA 01- 12	Ineffective property management controls	N/A	N/A	14.855 and 14.857
SA 01- 13	Inadequate documentation of participant files	17,640	N/A	14.855 and 14.857
<u>Section 8 - Project-Based Cluster</u>				
SA 01- 14	Inadequate cash management procedures	N/A	N/A	14.856
SA 01- 15	Inadequate documentation of participant files	24,132	N/A	14.856
<u>HUD Disaster Recovery Initiative</u>				
SA 01- 16	Inadequate cash management procedures	2,079	N/A	B-98MU-72-0003
SA 01- 17	Noncompliance with period of availability of federal funds	44,104	N/A	B-98MU-72-0003
SA 01- 18	Ineffective controls over preparation and submission of federal financial reports	N/A	N/A	B-98MU-72-0003
<u>Welfare-to-Work</u>				
SA 01- 19	Inadequate cash management procedures	N/A	N/A	17.253
<u>Workforce Investment Act</u>				
SA 01- 20	Inadequate cash management procedures	N/A	N/A	17.255

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2001

3. Findings and Questioned Costs for Federal Awards...Continued

<u>Reportable Condition/Noncompliance</u>	<u>Known Questioned Costs</u>	<u>Likely Questioned Costs</u>	<u>CFDA No.</u>
<u>Administration for Children, Youth and Families</u>			
SA 01- 21 Ineffective controls over preparation and submission of federal financial reports	N/A	N/A	93.600
SA 01- 22 Failure to meet full enrollment level	150,086	N/A	93.600
SA 01- 23 Inadequate cash management procedures	25,810	N/A	93.600
SA 01- 24 Failure to meet the minimum required average daily attendance level	N/A	N/A	93.600
SA 01- 25 Noncompliance with the Davis Bacon Act	76,305	N/A	93.600
<u>HIV Cluster - HIV Emergency Relief Project and Formula Grants</u>			
SA 01- 26 Lack of formal accounting records to support federal financial reports	N/A	N/A	93.914 and 93.915
SA 01- 27 Ineffective monitoring procedures	N/A	N/A	93.914 and 93.915
SA 01- 28 Funds disbursed after period of availability	N/A	N/A	93.914 and 93.915
<u>Public Safety Partnership and Community Policing Grants</u>			
SA 01- 29 Noncompliance with nonsupplanting requirements	N/A	N/A	16.710
<u>Public Assistance Grants</u>			
SA 01- 30 Lack of formal accounting records to support federal financial reports	N/A	N/A	83.544
SA 01- 31 Federal financial reports not submitted to federal grantor	N/A	N/A	83.544
<u>Loan Guarantee Assistance</u>			
SA 01- 32 Amounts due from general fund	N/A	N/A	14.218
SA 01- 33 Noncompliance with pledge requirement	N/A	N/A	14.218
SA 01- 34 Failure to monitor program income producing act.	N/A	N/A	14.218
Total Questioned Costs	<u>\$ 426,449</u>	<u>\$ 10,000</u>	

MUNICIPALITY OF PONCE, PUERTO RICO

PART III

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS



ESTADO LIBRE ASOCIADO DE PUERTO RICO
Gobierno Municipal Autónomo de Ponce
Oficina del Alcalde

Rafael Cordero Santiago
Alcalde

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the General Purpose Financial Statements for the Fiscal Year ended June 30, 2001. Under the heading Corrective Action Taken there will be the following:

- F Fully resolved (indicating the corrective action plan was fully implemented).
P-R Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2000-2001).
N-R Not resolved yet. Finding repeated in fiscal year 2000-2001.

		<u>Corrective Action Taken</u>
Finding 00-1 -	Operating Deficit of General Fund	P-R
Finding 00-2 -	Failure to Appropriate Funds for the Amortization of Accumulated Deficit	F
Finding 00-3 -	Available Balance Certification not submitted with Budgetary Transfers	F
Finding 00-4 -	Expenditures Quarterly Reports not submitted	P-R
Finding 00-5 -	Estimates of Expenditures not Submitted	P-R
Finding 00-6 -	Lack of Supporting Documentation for Budgeted Revenue Accounts	N-R

Finding 00-7 -	Inadequate Accounting Practices and Policies	P-R
Finding 00-8 -	Inadequate Accounting for Interfund Transactions	P-R
Finding 00-9 -	Inactive and Unnecessary Funds and Accounts are Not Closed	P-R
Finding 00-10 -	Checks Outstanding in Excess of Six Months	N-R
Finding 00-11 -	General Fund Bank Reconciliations no properly signed by Finance Director	F
Finding 00-12 -	Purchase Order Prepared After Service was Received	N-R
Finding 00-13 -	Failure to Withhold Payments to Tax Debtors	F
Finding 00-14 -	Accounts Payable per General Ledger does not Agree with Accounts Payable Subsidiaries	F
Finding 00-15 -	Noncompliance with Public Bid Documentation Requirements	F
Finding 00-16 -	Noncompliance with the Certification of Availability of Funds	F
Finding 00-17 -	Inaccurate Computation of Accrued Vacations, Sick Leave and Compensatory Time	F
Finding 00-18 -	Inadequate Controls and Accounting Practices Over the Fixed Assets Subsidiary Ledger	P-R
Finding 00-19 -	Lack of Property Physical Inventory	N-R

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Over Compliance Applicable to Each Major Federal Award Program for the Fiscal Year ended June 30, 2001. Under the heading Corrective Action Taken there will be the following:

- F Fully resolved (indicating the corrective action plan was fully implemented).
- P-R Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2000-2001).
- N-R Situation not resolved yet. Finding repeated in fiscal year 2000-2001.

	<u>Corrective Action Taken</u>
Finding SA-00-01 - Lack of Reconciliation Procedures	N-R
Finding SA-00-02 - Amounts due from General Fund	P-R
Finding SA-00-03 - Unsupported Difference in Bank Reconciliation	P-R
Finding SA-00-04 - Financial Summary Report is Inaccurate	N-R
Finding SA-00-05 - Inadequate Cash Management Procedures	N-R
Finding SA-00-06 - Unliquidated Obligations of Closed Program years not Credited to Federal Program	P-R
Finding SA-00-07 - Failure to Monitor Program-Income Producing Activities	N-R
Finding SA-00-08 - Inadequate Property Management Procedures	N-R
Finding SA-00-09 - Bank Reconciliations not Properly Signed by Finance Director	F

Finding SA-00-10 -	Inadequate Cash Management Procedures	N-R
Finding SA-00-11 -	Amounts Due from General Fund	P-R
Finding SA-00-12 -	Ineffective Property Management Controls	N-R
Finding SA-00-13 -	Inadequate Cash Management Procedures	N-R
Finding SA-00-14 -	Bank Reconciliations Not Properly Signed by Finance Director and Subdirector	F
Finding SA-00-15 -	Bank Reconciliations Not Properly Signed by Finance Director and Subdirector	F
Finding SA-00-16 -	Noncompliance with Non-Supplanting Requirements	N-R
Finding SA-00-17 -	Ineffective Cash Management Procedures	Program closed
Finding SA-00-18 -	Bank Reconciliations Not Properly Signed by Finance Director and Subdirector	F
Finding SA-00-19 -	Inadequate Property Management Procedures	F
Finding SA-00-20 -	Lack of Formal Accounting Records to Support Federal Financial Reports	N-R
Finding SA-00-21 -	Federal Financial Reports not Submitted to Federal Grantor	N-R
Finding SA-00-22 -	Bank Reconciliations Not Properly Signed by Finance Director and Subdirector	F
Finding SA-00-23 -	Ineffective Controls Over Preparation and Submission of Federal Financial Reports	N-R
Finding SA-00-24 -	Failure to Meet Full Enrollment Level	N-R
Finding SA-00-25 -	Inadequate Cash Management Procedures	N-R
Finding SA-00-26 -	Failure to Meet the Minimum Required Average Daily Attendance Level	N-R

Finding SA-00-27 -	Ineffective Reconciliation and Follow-Up Procedures	F
Finding SA-00-28 -	Lack of Formal Accounting Records to Support Federal Financial Reports	N-R
Finding SA-00-29 -	No Documentation Available to Support Compliance with the Suspension and Debarment Requirement	F
Finding SA-00-30 -	Ineffective Monitoring Procedures	N-R
Finding SA-00-31 -	Inadequate Cash Management Procedures	F
Finding SA-00-32 -	Amount Due from General Fund	N-R
Finding SA-00-33 -	Noncompliance with Pledge Requirement	N-R
Finding SA-00-34 -	Failure to Monitor Program-Income Producing Activities	N-R

MUNICIPALITY OF PONCE, PUERTO RICO

PART IV

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON THE AUDIT OF THE
GENERAL PURPOSE FINANCIAL STATEMENTS**

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

BUDGETING

Finding Number 01-01: Operating Deficit of General Fund (Prior Report Finding Number 00-01)(First Reported 1986):

The Municipality's system of internal control relating to the Budgeting function does not adequately prevent operating management from incurring expenditures in excess of the level of funds appropriated and available. The Municipality closed its fiscal year ended June 30, 2001 with an unreserved fund balance deficiency in the general fund of approximately \$20.2 million.

This occurs because the budgeting system does not reflect actual available revenues and therefore cannot prevent the obligation of expenditures for which current resources will not be available. As part of the preparation of the budget for fiscal year 2000-2001, the Municipality estimated certain revenues related to legal cases for which a decision favorable to the Municipality had been reached or was expected to be reached. However, the resulting proceeds were not received during the year and the budgeted revenues were not adjusted to reflect the actual funds available.

Article 8.004 (b) of the Municipalities Law establishes that the Municipality cannot obligate or spend funds in excess of the appropriations for the ensuing fiscal year. In addition, according to Chapter IV, Section 17, of the Basic Standards, the responsibility of oversight to prevent deficits in any municipal fund rests with the Finance Director.

The continued occurrence of this situation could result in the eventual reduction or elimination of municipal services since future revenues will need to be used to pay for accumulated liabilities.

Recommendation:

The Municipality should revise and amend the budget as current information related to collections of budgeted revenues became available.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

BUDGETING

Finding Number 01-02: Expenditures Quarterly Reports not Submitted (Prior Report Finding Number 00-04) (First Reported 1997):

The Municipality does not have a reliable financial reporting system that ensures the preparation and submission of quarterly reports for the use of funds assigned to each Municipal Department. During our audit we noted that the Municipal Departments failed to submit to the Mayor the required quarterly report.

This condition results from the failure of Municipal Department Directors to monitor compliance with the required reporting requirements by ensuring the timely preparation and submission of financial reports.

Chapter II, Section 5(1) of the Basic Standards requires from each of the Municipal Department Directors to prepare and submit to the Mayor an estimate of expenditures per quarter. This information should be used by the Finance Director to prepare a general quarterly report. Copies of this report should be forwarded to the Mayor, Internal Auditor and to the Office of the Commissioner of Municipal Affairs.

Recommendation:

The Municipality should establish a reporting calendar which informs all Department Directors of the due dates of each financial report. The reporting calendar will help to establish the priorities by ensuring that the management is aware of the need to accurately and promptly close the books therefore allowing time for the accurate and timely submission of the financial reports.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

BUDGETING

Finding Number 01-03: Estimates of Expenditures not Submitted (Prior Report Finding Number 00-05) (First Reported 1999):

The Municipality's system of internal control over the preparation of the annual budget of the general fund is not effective. We noted that 4 out of 24 Municipal Departments, (16%), did not submit the estimates of expenditures for the preparation of the 2000-2001 operational budget of the general fund to the Budget Department. The departments in which this exception occurred were as follows:

<u>DEPARTMENT</u>	<u>APPROVED BUDGET</u>
Oficina del Alcalde	\$ 2,897,370
Presupuesto	1,344,841
Defensa Civil	1,458,060
C.I.D.E.S.	114,341
	<u>\$ 5,814,612</u>

The approved budget for these departments represents 8% of the total budget of the general fund which totaled approximately \$72.2 million.

This condition results from the failure of the corresponding Department Directors to monitor compliance with the reporting requirements by ensuring the timely preparation and submission of expenditure estimates to the Budget Department. In addition, the Budget Department failed to follow-up and obtains the documents before the preparation and approval of the general fund's budget. Accordingly, the budgets for these departments were approved without being reviewed and analyzed by the Budget Department.

Chapter II, Section 4(1) of the Basic Standards requires each of the Municipal Department Directors to prepare and submit to the Budget Department an estimate of expenditures for the year. This information should be used by the Budget Department to prepare the operational budget for the year.

The continued failure to obtain the estimate of expenditures may result in the approval of amounts either in excess of or less than those necessary to meet the actual needs of the corresponding departments. Furthermore, deviations from budget will be difficult to analyze since the original detail is not available for comparison with actual expenditures within the department.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

BUDGETING

Finding Number 01-03: Estimates of Expenditures not Submitted (Prior Report Finding Number 00-05) (First Reported 1999)...(Concluded):

Recommendation:

The Municipality should establish a reporting calendar which informs the Department Directors of the due dates of each financial report. The calendar will help to establish priorities by ensuring that management is aware of dates that expenditure estimates should be submitted to the Budget Department. Department Directors must ensure compliance with reporting deadlines. The Budget Director should not submit the budget for the approval of the Mayor and the Municipal Assembly whenever there are significant unsupported amounts included within the budget. The Mayor and Municipal Assembly should consider appropriate action to be taken against Departments that do not submit information. Such action could include budget reductions or other penalties to operations.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

BUDGETING

Finding Number 01-04: Lack of Supporting Documentation for Budgeted Revenue Account (Prior Report Finding Number 00-06)(First Reported 1999):

The Municipality is not effectively identifying the sources of the information that should support the revenue estimates included in the budget of the general fund. We noted that 2 revenue accounts were budgeted without the required supporting documentation as follows:

<u>Account Number</u>	<u>Description</u>	<u>Budgeted Amount</u>
010-03-04-00-00-87.05	Ingresos Eventuales	\$ 8,373,130
010-03-04-00-00-87.09	Other Revenues	1,748,165

This situation results from the Municipality's Budget Department's failure to obtain the required supporting documentation for the budgets of the revenue accounts. Accordingly, the budgeted revenues were approved without documentation and analysis as to the reasonableness of the amounts and the propriety for recognition as revenues. The accounts listed above represent approximately 14% of the general fund's budget of approximately \$72.2 million.

Chapter II, Section 3 of the Basic Standards requires the revenue estimates to be classified by fund and by source of income. Furthermore, revenue estimates should be based on prior collection experience, trends and economic predictions. In addition, the Basic Standards require that special care should be taken in the preparation of the revenue estimates in order for them not to be overstated.

The continued occurrence of this situation could result in the Municipality incurring deficits as a result of spending amounts in excess of the available resources because of the possibility that the budgeted revenues will not materialize since there is no supporting information as to their source or as to the reasonableness of the amount.

Recommendation:

The Municipality should only budget revenues that have adequate support to ensure the reasonableness of the estimate. The information should be in the form of analyses and memoranda that establish the events and amounts that are expected to result in revenue recognition. The Budget Director should not submit the budget for the approval of the Mayor and the Municipal Assembly whenever there are significant unsupported amounts included within the budget.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

BUDGETING

FINDINGS NOT REPEATED FROM PRIOR AUDIT

- Finding Number 00-02: Failure to Appropriate Funds for the Amortization of Accumulated Deficit – The Municipality did not have a deficit at June 30, 2001 and therefore, was not required to appropriate funds.
- Finding Number 00-03: Available Balance Certification not Submitted with Budgetary Transfers or not Approved by Finance Director – Our audit procedures did not disclose that this deficiency was repeated during the current year.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-05: Inadequate Accounting Practices and Policies (Prior Report Finding Number 00-07)(First Reported 1986):

The Municipality does not have the accounting practices, policies or internal controls in place to provide for the preparation of financial statements, on a timely basis, in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). The accounting system only provides for the recording of revenues, expenditures, certain balance sheet accounts and a limited number of other transactions. Therefore, the general-purpose financial statements must be prepared using financial information obtained from various departments and accounting records. The records are not integrated, and do not follow a double entry system (debits and credits). As a result the records required significant adjustment in order to present the financial position and results of operations of the Municipality in conformity with generally accepted accounting principles.

There were significant differences between the records kept at the accounting department and those for the federal programs. Financial reports for all fund types showing the financial position and results of operations following generally accepted accounting principles are only prepared at the time of the annual audit.

The Municipality does not maintain adequate records of outstanding long-term obligations. The practice is to rely upon the notification received from the Government Development Bank for Puerto Rico or the Federal government for the balance of its outstanding debt and the withholdings for its debt service.

In addition, records for general fixed assets are not reliable.

The continued failure to have an adequate accounting system prevents the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions when plans and objectives are not being met.

This situation also heightens the possibility of significant financial reporting problems and delays in reporting when the Municipality must implement the requirements of Statement of Governmental Accounting Standards No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*", ("SGAS 34"). This Statement is applicable to the Municipality's fiscal year June 30, 2002 financial statements. Failure to prepare and meet this requirement may significantly affect our auditors' report on the general-purpose financial statements in the near future.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-05: Inadequate Accounting Practices and Policies...(Concluded):

In summary, the current accounting system does not comply with the requirements established in Article 8.010, Sections (b) and (c) of the Municipalities Law. These sections provide the following:

Section (b) - Municipal accounting shall be kept by funds and in conformity with generally accepted accounting principles and the requirements established by the Governmental Accounting Standards Board. Also, it should be based on the pronouncements of the National Committee on Governmental Accounting and the book Governmental Accounting, Auditing and Financial Reporting. This publication should serve as the basis for designing the accounting practices and policies to allow for the preparation of the general-purpose financial statements.

Section (c) - The accounting system should provide:

1. the complete results of the Municipal operations,
2. the proper and necessary financial information for the efficient administration of the Municipality,
3. effective controls and the accountability of all the funds, property and other municipal assets,
4. information necessary for the preparation of accurate financial reports, that could be used in the preparation of the municipal budget.

Recommendation:

The Municipality should adopt and implement a plan to convert its accounting system to an integrated system that would allow for the monthly closing of the ledger, as well as the preparation of year-end financial statements in accordance with generally accepted accounting principles. This plan should provide for:

- assessment of the financial accounting and reporting needs in order to take the necessary steps to meet the financial reporting requirements of SGAS 34,
- the implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for the federal funds,
- the preparation of periodic financial reports to be submitted to the Mayor, the Finance Director, the Municipal Assembly and all other interested entities,
- adequate training of all accounting personnel to improve the understanding of the system and to promote operational efficiency,
- reconciliation of financial records with the reports prepared and submitted to the Federal government.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-06: Inadequate Accounting for Interfund Transactions (Prior Report Finding Number 00-08)(First Reported 1986):

The Municipality has not established appropriate accounting policies for the recording of interfund transactions. Transfers among different funds are accounted for as "expenditures" in the fund making the transfer and as "revenues" in the receiving fund. There are no subsidiary accounts to accurately account for the interfund receivable and payable balances.

The Municipality determined the amounts to be presented in the general-purpose financial statements after searching for transfer transactions in its accounting records; this process increases the risk that such transactions could be missed or incorrectly accounted for. No consideration is given to the nature of the transaction as a transfer or as an interfund loan. Accordingly, revenues, expenditures, and interfund receivables and payables were adjusted for financial reporting purposes to conform with the presentation in accordance with generally accepted accounting principles. As of June 30, 2001, the general fund owed \$3,390,306 to the special revenue funds, and the special revenue funds owed \$447,479 to the general fund.

Article 8.010, Section (b) of the Municipalities Law establishes that the accounting system shall provide for the accounting procedures and records to be maintained in accordance with generally accepted accounting principles applicable to governmental entities.

The lack of accounting records for interfund transactions may result in the use of one fund's resources to finance the activities of another fund, and the money not being reimbursed to the proper fund. Since most of the balance results from transfers to the general fund from federal financial assistance programs, they have been reported as questioned costs in previous years' Single Audit reports. Accordingly, there is the possibility that the Municipality may need to refund the balances of the amounts owed to the federal agencies, including the possibility of being assessed penalties and interest costs on such advances.

The accounting for interfund transactions is also important under the requirements of SGAS 34 and the Municipality will need to track the transactions so that they can be properly eliminated when preparing the government wide financial statements required by that Statement.

Recommendation:

The Municipality should establish and maintain a subsidiary ledger to accurately account for interfund transactions. Furthermore, the Municipality should immediately refund amounts owed to the federal funds to prevent the assessment of interest and penalties on such funds.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-07: Inactive and Unnecessary Fund and Account are Not Closed (Prior Report Finding Number 00-09)(First Reported 1986):

The Municipality is maintaining funds and accounts that have been inactive for a long period. The Municipality's accounting records include an account that has been inactive or did not have significant operations during the year 2000-01. The inactive account was the following:

<u>Account Name</u>	<u>Bank Account Number</u>	<u>Balance</u>
Rental Loan	129-06264	\$ 84

This occurs because the Municipality has not analyzed and closed inactive funds as well as the related bank accounts when the funds' objectives have been achieved or are no longer relevant. The continued maintenance of these funds and accounts exposes the Municipality to the unauthorized use of funds from inactive accounts for activities not intended to be financed with these funds and to accounting errors as a result of inappropriate postings to the accounts.

Article 8.007 (b), of the Autonomous Municipalities Law establishes that funds should be closed when the fund's objectives have been completed.

Recommendation:

The Municipality should determine whether the intended objectives of these funds were met. The Municipality should close all funds that have complied with the requirements. Remaining balances in those funds should be transferred in accordance with local and federal regulations.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-08: Checks Outstanding in Excess of Six Months (Prior Report Finding Number 00-10) (First Reported 1992):

The Municipality is not canceling outstanding checks, which have been outstanding for a period in excess of six months. Our testing of selected bank reconciliations revealed that there are 27 outstanding checks in the accounts totaling \$11,844 as of June 30, 2001 which have been outstanding for more than six months as detailed below:

<u>Account Title</u>	<u>Account Number</u>	<u>Number of Checks</u>	<u>Total Amount</u>
Aportaciones y Deducciones	071-867759	1	\$ 160
Resoluciones Conjuntas	071-867694	20	10,800
Existing	101-1030000081*	1	6
Voucher	101-1030000030*	3	335
Head Start	071-036938*	1	450
Workforce Investment Act	071-076492*	1	93
		<u>27</u>	<u>\$ 11,844</u>

*= Denotes federal program

This is caused by the lack of a regular monthly review and follow up of bank reconciliations, specifically those with many outstanding checks, and the need to establish investigation procedures to determine the underlying reasons as to why these checks have not been presented for payment.

Although Chapter IV, Section 11, of the Basic Standards establishes that checks outstanding for more than one year should be cancelled and the amount included in the cash balance, municipal checks are not valid six months after being issued.

This situation represents a possible understatement of cash and an overstatement of expenditures and, in the case of federal funds, could result in questioned and disallowed costs.

Recommendation:

The Municipality should evaluate the outstanding check lists on a monthly basis, and investigate checks that have not cleared the bank for an unreasonable period of time (i.e. three to six months), contact the payee and determine the underlying reasons as to why these have not been presented to the bank for payment.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-09: Bank Reconciliations Not Prepared on a Timely Basis (First Reported 1986):

The Municipality does not have effective internal controls to ensure the prompt reconciliation of bank accounts. Our review of the selected bank reconciliations for six bank accounts selected for testing revealed that bank accounts were not reconciled on a timely basis. The accounts and dates of reconciliations were as follows:

<u>Month Ended</u>	<u>Date Reconciled</u>				
	<u>Concentration</u> 071-867627	<u>Section 8</u> <u>Voucher</u> 101-1030000030*	<u>Section 8</u> <u>Moderate I</u> 101-1030000049*	<u>Amnistia de</u> <u>Patentes</u> 071-867724	<u>General</u> <u>Account</u> 101-1030000154
July 31, 2000		September 1, 2000			
October 31, 2000		December 19, 2000	December 18, 2000		
November 30, 2000	January 25, 2001	January 30, 2001		January 19, 2001	January 19, 2001
December 31, 2000		February 26, 2001			
January 31, 2001			March 16, 2001		
March 31, 2001			May 18, 2001		

* Denotes federal funds

These instances occur because the due date to complete the reconciliation of the bank accounts is not enforced by management. This may allow material errors to pass undetected or to not be detected on a timely basis.

Article 8.010(d) of the Municipalities Law establishes that the Municipality shall have adequate internal controls to prevent or detect possible errors or irregularities on a timely basis. Failure to reconcile bank accounts on a timely basis may result in errors to pass undetected for an extended period of time or not detected at all, thus, increasing the possibility of loss of funds due unauthorized transactions or errors. Also, the Municipality may fail to record required adjustments resulting from the reconciliations.

The sample tested was six accounts from an approximate universe of 18 general fund accounts (216 monthly bank reconciliations) and 40 special revenue fund bank accounts (480 monthly bank reconciliations). From each of the six accounts selected, a subsample of six months was selected for testing.

Recommendation:

Bank reconciliations should be prepared within 45 days after month end. Management should oversee the adherence to this internal control policy to improve the internal controls over the cash related functions.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

ACCOUNTING AND FINANCE DEPARTMENT

Finding Number 01-10: Untimely Contract of External Auditors:

The Municipality did not arrange for the timely contracting of the external audit for the performance of the fiscal year 2000-01 audit of its financial statements and compliance with laws and regulations related to federal awards. The Municipality contracted for the services of the external audit on June 29, 2001, two days before year-end.

Article 8.016 of the Autonomous Municipalities Law, as amended, requires the municipalities to contract the services of external auditors at least 90 days before the end of the fiscal year to be audited. In addition, Article 7.010(e) of the Law requires the municipalities to monitor its operations using several tools, one of which is the timely performance of the audits in accordance with OMB Circular A-133 and the Single Audit Act.

This condition results from the failure of the Finance Department to monitor compliance with the required contracting requirements by ensuring the external auditors are contracted within the allowed time period.

The continued failure to arrange for the timely contract of external auditors may result in sanctions from the Office of the Controller of Puerto Rico because the Municipality is not demonstrating its commitment to timely reporting of financial position and results of operations.

Recommendation:

The Municipality should arrange for the timely contract of external auditors to allow for the completion of the independent audit within the required time limit.

MUNICIPALITY OF PONCE, PUERTO RICO

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING
YEAR ENDED JUNE 30, 2001**

ACCOUNTING AND FINANCE DEPARTMENT

FINDING NOT REPEATED FROM PRIOR AUDIT

- Finding Number 00-11: General Fund Bank Reconciliations Not Properly Signed by Finance Director and Subdirector – Our audit procedures did not disclose that bank reconciliations were not properly signed by finance director and subdirector.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

PURCHASES, PAYABLES AND PAYMENTS

Finding Number 01-11: Purchase Order Prepared After Service Was Received (Prior Report Finding Number 00-12)(First Reported 1986):

The Municipality's system of internal control over purchasing and payments is not effectively preventing acquisition of goods and services without the preparation of the corresponding purchase order. For the following three of 9 disbursements tested (33%) for the year ended June 30, 2001 the purchase orders were prepared after the services were received:

Disbursement Voucher		
Number	Date	Amount
1001067	September 21, 2000	\$ 6,555
1002664	November 28, 2000	6,750
1000829	September 11, 2000	6,688

Chapter VIII, Part IV, Section 2(2) of the Basic Standards requires that municipalities encumber the appropriations in the budgetary accounting records before the actual purchase of materials, equipment or services in order to ensure the availability of the funds to pay for the goods or services when received. Furthermore, Section 2(3) establishes that the Municipalities may not acquire goods, equipment or services without a corresponding purchase order.

The continued occurrence of this situation may result in the obligation of funds in excess of the available unencumbered amounts.

The sample tested consisted of 25 disbursements from an approximate universe of 48,387 disbursements. The dollar value of the sample tested was approximately \$100,000 and the universe of disbursements, in dollars, was approximately \$69 million for the year ended June 30, 2001.

Recommendation:

The Municipality should determine that purchase orders are prepared and processed and the corresponding encumbrance is recorded prior to the actual issuance of the purchase orders to suppliers. This will prevent the receiving of goods and services for which the purchase orders have not been approved due to insufficient budget amounts available. No payments should be made when the purchase order has not been prepared prior to the receipt of the goods or services. Any instances of noncompliance should be referred to the Internal Auditor for further investigation, and reported to the Mayor.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

PURCHASES, PAYABLES AND PAYMENTS

FINDINGS NOT REPEATED FROM PRIOR AUDIT

- **Finding Number 00-13: Failure to Withhold Payments to Tax Debtors – Our audit procedures for the year ended June 30, 2001 did not disclose instances where the Municipality failed to withhold payments to tax debtors.**
- **Finding Number 00-14: Accounts Payable per General Ledger does not Agree with Accounts Payable Subsidiaries – Our audit procedures for the year ended June 30, 2001 revealed that accounts payable balances in the general ledger agree with accounts payable subsidiaries.**
- **Finding Number 00-15: Noncompliance with Public Bid Documentation Requirements – Bids examined during the audit for the year ended June 30, 2001 include the minutes describing the details of the bid opening and awarding processes.**
- **Finding Number 00-16: Noncompliance with the Certification of Availability of Funds - Bids examined during the audit for the year ended June 30, 2001 include the certification of availability of funds.**

MUNICIPALITY OF PONCE, PUERTO RICO

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING
YEAR ENDED JUNE 30, 2001**

PAYROLL AND PERSONNEL

FINDING NOT REPEATED FROM PRIOR AUDIT

- Finding Number 00-17: Inaccurate Computation of Accrued Vacations, Sick Leave and Compensatory Time – Our audit procedures for the year ended June 30, 2001 did not reveal instances of inaccurate computations of accrued vacations, sick leave and compensatory time.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

PROPERTY MANAGEMENT

Finding Number 01-12: Inadequate Controls and Accounting Practices Over the Fixed Assets Subsidiary Ledger (Prior Report Finding Number 00-18)(First Reported 1986):

The Municipality does not have an effective system to account for fixed assets. There are no controls in place to assure that all property expenditures which should be capitalized or property dispositions are recorded in the fixed assets subsidiary ledger. Procedures are not in place to require that real property acquired with federal and local funds be recorded in the property subsidiary ledger or that any property sales and dispositions be accounted for in the fixed assets subsidiary ledger.

This condition occurs because there are no established procedures to prepare the adjustments necessary to record these transactions in the fixed assets subsidiary ledger.

Article 8.013 of the Municipalities Law and Chapter VII of the Basic Standards establish that the Municipality shall be responsible to safeguard and be accountable for its fixed assets (both real and personal property).

Chapter VII, Sections 3, 4, 14, 15 and 21 of the Basic Standards establishes the following guidelines regarding property management:

Section 3 establishes that the Finance Director is responsible for the accountability of the capital assets acquired by the Municipality through purchases or donations.

Section 4 establishes that the Municipal Property Administrator shall be responsible to the Mayor and the Finance Director for the direct administration, use and maintenance of the entire real and personal property owned by the Municipality.

Section 14(1) establishes that all Municipal property shall be numbered and identified as to ownership by the Property Department Director.

Section 15(1) establishes that the Property Department Director is responsible for accurately maintaining the central property records.

Section 21(c) establishes that management shall write-off from the property records all property and equipment sold or disposed of when certified by the Internal Auditor of the Municipality upon determination that such disposal is adequate.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

PROPERTY MANAGEMENT

Finding Number 01-12: Inadequate Controls and Accounting Practices Over the Fixed Assets Subsidiary...(Concluded):

The continued failure to have accurate and complete property records has resulted in a disclaimer with respect to the general fixed assets account group. Under the requirements of Statement 34 this can result in a disclaimer of opinion of the entity wide statements. Furthermore, this situation represents a significant risk of loss of property and equipment because there is a lack of accountability for acquired assets. The value of federally funded property that may be lost would need to be repaid to the federal government with local funds.

Recommendation:

The Property Division must require each division that acquires property and equipment to submit a report including a full description of the asset, location, use, responsible personnel, cost and any other pertinent data. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Sales or other dispositions must also be made only upon approval of the Property Division Director and the Finance Director, and should be carried out by persons other than the users, and through public announcement or bids.

The Accounting Department should establish a property control account to provide for the reconciliation of property recorded in the subsidiary ledger with that recorded in the control account. In addition, the subsidiary ledger shall be periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal funds offices, such as JTPA, Head Start, and Housing and Urban Development (HUD).

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING YEAR ENDED JUNE 30, 2001

PROPERTY MANAGEMENT

Finding Number 01-13: Lack of Property Physical Inventory (Prior Report Finding Number 00-19) (First Reported 1986):

The Municipality is not performing periodic physical inventories of its property and equipment for certain Municipal departments. The Municipality was not able to provide evidence that a physical inventory was performed for 7 out of 25 (28%) Municipal departments as follows:

Obras Públicas y Control Ambiental	Fomento Turístico
Arte y Cultura	Centro Histórico
Defensa Civil	Fomento Industrial
Prensa y Comunicación	

In addition, we noted that for 14 Municipal Departments for which a physical inventory was performed during the year, there were unreconciled differences between the physical inventory quantity and the amounts recorded in the Municipality's records. The departments in which the exceptions occurred were the following:

Oficina del Alcalde	Ornato	Servicios Humanos
Administrador de la Ciudad	Recreación y Deportes	Servicios Legales
Secretaría Municipal	Transporte	
Finanza y Tesorería	Ordenación Territorial	
Oficina de Presupuesto	Oficina de Permisos	
Recursos Humanos	Guardia Municipal	

The Property Division has not enforced the requirement for the departments to both perform a property inventory and to ensure the proper accountability of assets. According to the existing records of the Municipality, the cost of the property owned by the Municipality is approximately \$134.2 million as of June 30, 2001. There is a significant risk of unauthorized use or disposition because there are no controls to ensure accountability of assets by department/division.

Chapter VII, Section 22 of the Basic Standards establishes that property physical inventories should be performed on an annual basis, as part of the overall property management control of the Municipality and differences, if any, should be investigated and reconciled.

Accordingly, the Municipality's internal control over property and equipment is not designed to effectively account for its property since it does not allow for the reconciliation of detailed property records with the general ledger. This inadequate property control may expose the Municipality to cost disallowance by the federal government for lost or stolen federal property acquired with federal funds.

Recommendation:

A physical inventory of the Municipality's property should be performed as soon as possible for all departments and all differences should be investigated, adjusted and reconciled with the property recorded on the subsidiary ledgers. Furthermore, the Mayor should issue an executive order to require compliance with this requirement.

MUNICIPALITY OF PONCE, PUERTO RICO

PART V

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO FEDERAL PROGRAMS**

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

FINDING RELATED TO FEDERAL PROGRAMS THAT HAVE A SEPARATE ACCOUNTING DEPARTMENT AND ADMINISTRATIVE UNIT

Finding Number SA-01-01: Lack of Reconciliation Procedures (Prior Report Finding Number SA-00-01)(First Reported 1988):

The Municipality has not established the appropriate system of internal control to ensure the timely and accurate reconciliation of the accounting records maintained by program accountants with those maintained at the Municipality. Funds received from the U.S. Department of Housing and Urban Development for the Community Development Block Grant and Section 8 Clusters; from the U.S. Department of Health and Human Services for the Head Start; and from the U.S. Department of Labor for the Workforce Investment Act and Welfare-to-Work Programs, are managed by their own administrative personnel including their own accounting departments. Each maintains a separate set of accounting records kept on a double entry system. However, the Municipality's central accounting department, has not established the necessary policies and procedures for the reconciliation of the transactions recorded in the Program's accounting records with those recorded in the Municipality's central accounting department.

In addition, the cash balances per programs' general ledgers do not agree with the bank reconciliations prepared by the Municipality for the following federal programs: CDBG, Section 8 Tenant and Project Based Clusters, Welfare to Work and Workforce Investment Act.

This condition results in the possibility of not detecting or preventing errors or irregularities on a timely basis because there is no central oversight of all of the Municipality's financial operations. The Finance Director is currently placing reliance upon the accounting records maintained by each of the Programs without having any control procedure to detect inconsistent accounting treatments.

The Municipality should be aware of its responsibility for administering the grants even though a separate fiscal unit or department is assigned the responsibility of administering the funds.

Questioned Costs: None.

Recommendation:

The Municipality should implement monthly reconciliations of the transactions recorded in each of the programs with the transactions processed and recorded in the central accounting department. In addition, it should ensure that all federal financial reports are prepared based on the financial information once reconciled.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG) (CFDA #14.218)

PROGRAM DESCRIPTION

The primary objective of the CDBG Program is the development of viable urban communities, decent housing, suitable living environment, and expanded economic opportunities, principally for persons of low and moderate income. This is to be achieved in two ways. First, funds can only be used to assist eligible activities that fulfill one or more of three national objectives: (1) benefiting low-and moderate-income persons; (2) aiding in the prevention or elimination of slums or blight; (3) meeting other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community, and where other financial resources are not available to meet these needs. Secondly, the grantee must spend at least 60% of its funds over a period of up to three years specified by the grantee in its certification for activities that address the national objective of benefiting low- and moderate-income persons.

This Program is conducted by metropolitan cities and urban counties that must submit certain certifications along with a statement as to how they propose using the funds for community development activities. The grant amount is based on a formula that considers the community's population, poverty, extent of overcrowded housing, age of housing, and growth lag.

The CDBG Program also provides for the granting of loan guarantees under HUD Section 108, Loan Guarantee Assistance (LGA). Accordingly, these activities are included as part of the CDBG audit. Findings related to the LGA Section 108 program, if any, will be identified as such.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to the CDBG federal financial assistance program.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-02: Amounts Due from General Fund (Prior Report Finding Number SA-00-02) (First Reported 1988):

The Municipality has not reimbursed the federal programs for amounts advanced in previous years to the general fund nor is it able to determine the nature and propriety of the differences discussed below. As of June 30, 2001, the Municipality's general fund owed the CDBG program \$1,116,301, resulting from:

- a) A transfer of federal funds to finance general fund activities of \$392,113.
- b) an unreconciled difference (debit) in the accounting records of the federal program in the amount of \$724,188.

The following actions caused the above items to occur:

- a) The transfer of federal funds of \$392,113 was due to the failure to prevent the use of federal funds to finance non-federal activities by program and municipal management..
- b) The unreconciled difference of \$724,188 resulted from the failure of internal accounting records of the program to properly identify the actual cause or origin of the debit. Accordingly, management has not been able to determine the reason for this difference.

The Municipality is not in compliance with 24 CFR 570.200 for item "a", and 24 CFR 85.20(b)(1) for item "b". Item "a" of 24 CFR 570.200 establishes the eligible activities to be financed with these funds. However, none of the sections under this Title allow the transfer of federal funds to finance the activities of the general fund. In addition, item "b", 24 CFR 85.20(b)(1) establishes that federal funds recipients shall have a financial management system that will provide for the accurate, current and complete disclosure of the financial results of financially assisted activities.

This condition permits the financing of the general fund activities with federal funds and places additional financial limitations on the performance of the activities approved under the federal grant. Therefore this exposes the Municipality to cost disallowance for the amounts owed and may also result in the assessment of penalties and interest costs on amounts owed to the federal programs.

Questioned Costs: None since this amount has been included as a questioned cost in previous years Single Audit reports.

Recommendation:

The Municipality should seek resolution of this amount with the federal agency. In addition, the Municipality should not permit transfers of federal funds to finance activities not approved by the federal grantor and that are not in accordance with the grant agreements. Also, the Municipality should perform a detailed analysis to determine the nature and causes of the difference, and present the results to the federal grantor to determine the appropriate resolution of the difference.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-03: Unsupported Difference in Bank Reconciliation (Prior Report Finding Number SA-00-03) (First Reported 2000):

The Municipality identified an unsupported difference in its bank reconciliation of an old bank account related to the CDBG program, but has not completed an analysis to determine the underlying reason for the difference.

The balance sheet prepared by the program accountant as of June 30, 2000 presented the difference of \$255,470 as a "Deferred Charge". During fiscal year 2001 the program accountant identified and adjusted \$93,865 and the difference was reduced to \$161,605.

This occurred because the Municipality has not completed the required analysis in order to identify the underlying reasons for the difference, and make the proper adjustments to the financial statements and corresponding federal financial reports.

24 CFR 85.20 (b)(3) establishes that the federal fund recipients must maintain a financial management system that provides for the effective control and accountability of all grant and sub-grant cash, among all other assets. Furthermore, Section (b)(6) establishes that the accounting records must be supported by source documentation. In the case of reconciling items in bank reconciliations, these must be supported by the underlying documents or information.

The failure to investigate and dispose of this difference on a timely basis results in the possibility of funds being disposed without the authorization of the Municipality, or of these being used for unauthorized uses.

Questioned Costs: None since this amount has been included as a questioned cost in previous years Single Audit reports.

Recommendation:

The Municipality should immediately investigate the underlying reasons for the remaining difference, submit the necessary evidence to the federal grantor, and adjust its accounting records and federal financial reports as appropriate.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-04: Financial Summary Report is Inaccurate (Prior Report Finding Number SA-00-04) (First Reported 1992):

The Municipality's system of internal control relating to the preparation of federal financial reports is not effective. The Municipality is not ensuring that the Financial Summary Report ("FSR") submitted to the federal grantor contains accurate financial information. The FSR included within the Consolidated Annual Performance Evaluation Report ("CAPER") for the fiscal year ended June 30, 2001 showed the following errors:

<u>Line on Report</u>	<u>Amount per Report</u>	<u>Amount per Books</u>	<u>Difference</u>
Part II, Line 12 - Disbursed for planning and administration	\$ 1,435,341	\$ 1,307,470	\$ 127,871

In addition, the report shows an unreconciled difference of \$2,935,941 between the line of credit and cash balance and the unexpended balance shown in the FSR.

The above differences result from prior year adjustments not being recorded on a timely basis in the accounting books of the Program and/or are due to the lack of reconciliation procedures between the books and financial reports submitted to the federal grantor.

The 24 CFR 85.20 (b)(1) establishes that federal funds recipients shall have a financial management system that will provide for the accurate, current and complete disclosure of the financial results of financially assisted activities.

The continued occurrence of this situation may result in sanctions by the federal grantor because the information provided in the FSR does not allow them to adequately monitor and evaluate the Program's financial performance.

Questioned Costs: None.

Recommendation:

Program management should review and corroborate the information included in the FSR before submission to the federal grantor to ensure that all information is accurately presented. In addition, whenever significant adjustments or modifications are deemed necessary, the Municipality should amend submitted reports and include the appropriate supporting explanations.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-05: Inadequate Cash Management Procedures (Prior Report Finding Number SA-00-05) (First Reported 1994):

The Municipality's internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursement of funds. We selected 25 cash requisitions, out of 86 requisitions for this program, and within these requisitions we selected 95 expenditures paid and noted that for 9 of them (9%) the payment was made as follows:

<u>Date Funds Received</u>	<u>Check Date</u>	<u>Working Days Elapsed</u>	<u>Payee</u>	<u>Check Number</u>	<u>Amount</u>
July 12, 2000	July 19, 2000	4	Tesorero Municipal	3294	\$ 1,784
July 12, 2000	July 19, 2000	4	Olga Maria Arroyo Ramos	3291	542
July 12, 2000	July 19, 2000	4	Comercial San José	3290	4,719
July 12, 2000	July 19, 2000	4	Albergue La Providencia	3289	10,880
January 22, 2001	January 26, 2001	4	Comercial San José	3816	4,183
January 22, 2001	January 26, 2001	4	Downtown Development Corp.	3813	6,400
January 22, 2001	January 26, 2001	4	R&G Electronics	3814	1,700
March 29, 2001	April 23, 2001	14	Fondo Seguro Estado	4040	3,306
March 29, 2001	April 23, 2001	14	Fondo Seguro Estado	4041	114

The above delays are the result of inadequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs relating to the excess cash on hand which would be paid from local funds.

The 24 CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.

Questioned Costs: \$1,782, representing interest on the excess balance at the federal funds rate.

Recommendation:

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by CDBG regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-06: Unliquidated Obligations of Closed Program Years not Credited to Federal Program (Prior Report Finding Number SA-00-06) (First Reported 1997):

The Municipality does not have effective internal controls over compliance with the requirements relating to unliquidated obligations. We noted that as of June 30, 2001, the Municipality has not liquidated its "accounts payable" for the following program years:

<u>Grant Year</u>	<u>Balance</u>
1991	\$23,481
1993	10
Total	<u>\$23,491</u>

The Municipality has not investigated the reasons why the invoices have not been received for the payables encumbered in order to determine whether to issue the corresponding payment or to credit the federal program for amounts that will not be paid.

24 CFR 85.22(b) establishes that the Municipality should comply with the cost principles included in OMB Circular A-87, paragraph C.4. The Circular establishes that applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate. Since the program years to which these payments are related were already closed, and since these accounts have not changed for several years, the payments should either be made to the corresponding suppliers or credited to the federal grantor for amounts not claimed by suppliers. Therefore, these amounts are considered to be applicable credits to the federal program.

The failure to credit the federal programs with applicable credits may result in cost disallowances since the program was charged for expenditures that will not be paid.

Questioned Costs: \$23,491.

Recommendation:

The Municipality should reimburse the federal grantor for the above amounts as soon as possible, and adjust its accounting records to eliminate the accounts payable. Furthermore, grant closeout procedures should include the investigation and payment of all grant liabilities or the return of such funds to the federal grantor.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-07: Failure to Monitor Program-Income Producing Activities (Prior Report Finding Number SA-00-07) (First Reported 1997):

The Municipality does not have internal controls in place relating to compliance with the requirement to monitor the activities of income producing activities that are funded with Program grants. During our audit over the funds granted for the operations or to other entities, we noted that the Municipality has not established controls to ensure that such funds are being used, together with the corresponding program income that arises from the operation of such entities/facilities, in accordance with program rules and regulations. During the year ended June 30, 2001, the Municipality provided funds to the following entities, which also generated program income from their activities:

Serrallés Castle	Cruceta del Vigía
Tibes Indian Ceremonial Center	Caribbean Artisan Plaza
La Perla Theatre	Salvador Dijols Basketball Court
Art and Culture Plaza (Historic Museum)	Department of Sports and Recreation

This situation has occurred because the Municipality has not established internal controls to monitor the compliance of these entities/facilities. Also, the Municipality has failed to establish internal controls over financial reporting to ensure that these activities are properly accounted for and recorded in the Municipality's accounting records, as required by federal regulation.

The 24 CFR, Part 570.504 and 24 CFR Part 85, Sections 85.20 (b)(1)(2) and 85.21 (f) establish that the grantee must implement the necessary controls for identifying income producing activities, recording and using program income in accordance with applicable grant agreements and regulations.

The continued failure to monitor income producing activities may allow funds to be used for ineligible activities exposing the Municipality to cost disallowances for the amounts transferred as well as for program income collected and not used in eligible activities.

Questioned Costs: Unable to determine since the Municipality does not have separate records to account for these revenues, but is estimated to exceed \$10,000.

Recommendation:

The Municipality's internal auditor should include monitoring the activities of the aforementioned program-income producing activities within the annual work plan. This should be performed immediately for all years for which funding has been provided to finance these activities. The internal auditor should conclude as to whether the funds were used in accordance with applicable grant provisions and regulations.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-08: Inadequate Property Management Procedures (Prior Report Finding Number SA-00-08)(First Reported 1997):

The Municipality does not have effective internal controls over compliance with the property management requirement. The Municipality took a physical inventory of program property, but the compilation report was not summarized nor compared to the property subsidiary ledger. In addition there is no periodic review of the use and location of program equipment to ensure that these are being used for program-related purposes. (See findings 01-12 and 01-13).

The above situation results from the failure to establish formal policies regarding property physical inventories, and to require reconciliation of the inventory with the property subsidiary ledger. Accordingly, this may expose the Municipality to the unauthorized use or disposition of property because there are not effective controls to detect or prevent these situations.

24 CFR 85.32(c)(4), (d)(3) and (4) state that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft shall be investigated and adequate maintenance procedures must be developed to keep the property in good condition.

The continued failure to establish internal controls over compliance with the above requirements expose the Municipality to unauthorized use or disposition of the programs' property and equipment.

Questioned Costs: None.

Recommendation:

The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)

Finding Number SA-01-09: Interest Earned Not Remitted to Federal Grantor (First Reported 1987):

The Municipality's compliance with the administrative requirement to remit interest earned in excess of \$100 per year on federal fund deposit accounts is not effective. During our audit we noted that the program did not remit to the federal grantor the interest income credited to the CDBG Program cash account as required by federal regulations. The CDBG Program cash account earned interest income of \$9,154 for the fiscal year 2000-2001. From such amount only \$6,055 was remitted to the federal grantor. The amount to be reimbursed to the federal grantor is \$3,099, corresponding to interest earned during the months of March through June 2001.

The 24 CFR 85.21 (i) establishes that grantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the federal agency. The grantee or subgrantee may keep interest amounts up to \$100 per year for administrative expenses.

This occurs because the Municipality has not established internal controls over compliance with the requirement to ensure that any interest earned is promptly remitted to the federal grantor. In addition, another cause for the excess interest earned is the ineffective cash management process of the Municipality because cash requests are made in excess of immediate needs and/or payments are not issued within three days after the receipt of federal funds requirement.

The continued failure to comply with this requirement may result in the assessment of interests and penalties from the federal grantor on the amounts owed, as well as the determination of additional restrictions on future funding.

Questioned Costs: \$9,154 of interest income earned during the year less \$6,055 remitted to the federal grantor before year-end.

Recommendation:

The Municipality CDBG Program should reimburse the federal grantor this and other amounts owed in previous years as a result of the same instance of noncompliance. In addition, the Municipality should establish and enforce a monitoring procedure within the Program to ensure that interest earned in excess of \$100 is remitted on a quarterly basis.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

PROGRAM DESCRIPTION

The Section 8 Tenant-Based Cluster is composed of the Section 8 Rental Voucher Program, and the Section 8 Rental Certificate Program. The objectives of the Programs are to provide rental assistance to help very low-income families afford decent, safe and sanitary rental housing. The subsidies provided by the Programs are considered tenant-based subsidies because when an assisted family moves out of a unit leased under either Programs, the assistance contract with the owner terminates and the family may move to another unit with continued rental assistance.

Under the Rental Certificate Program, the rent and utility costs normally may not exceed a HUD established fair market rent ("FMR") for the unit size in the area, and the tenant is generally required to pay 30 percent of adjusted monthly income toward rent and utilities (the "total tenant payment"). The Housing Assistance Payment ("HAP") made by the Public Housing Authority ("PHA") to the owner, makes up the difference between the rent the owner charges for the unit and the amount of the total tenant payment.

Under the Rental Voucher Program, apart from the requirement that the rent must be reasonable in relation to rents charged for comparable units in the private unassisted market, there is no limit on the amount of rent that an owner may charge for a unit or that the family may pay. Instead, the Rental Voucher subsidy is set based on the difference between the PHA's payment standard for the family's unit size and 30 percent of the family's monthly-adjusted income. This is the maximum amount of subsidy a family may receive regardless of the rent the owner charges for the unit. Therefore, rental voucher program participants may pay more or less than 30 percent of their monthly adjusted income toward rent and utilities, depending on whether the gross rent for the unit is more or less than the PHA's payment standard for the unit. A family in the Rental Voucher Program is required to pay at least 10 percent of the family's gross income toward rent and utilities. The approximate number of participants during the year ended June 30, 2001 for each program were:

	<u>CFDA Number</u>	
Rental Voucher Program	14.855	937
Rental Certificate Program	14.857	<u>29</u>
		<u>966</u>

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to these federal financial assistance programs.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-10: Inadequate Cash Management Procedures (Prior Report Finding Number SA-00-10)(First Reported 1987):

The Municipality's internal control over compliance with the cash management requirements of the federal program is not effective since it is holding excessive cash balances in its bank accounts. During our audit of the bank reconciliations of the Programs' cash accounts, (which is used by the Programs and pools the funds received under the Tenant-Based Cluster and the Project-Based Cluster) we noted that the average balance on hand and in books significantly exceeded the average cash need of all Programs. Following is a list of the average balances of cash on hand for the Programs, as well as during the fiscal year:

<u>Month Ended</u>	<u>Bank Balance</u>	<u>Book Balance</u>
July 31, 2000	\$ 1,791,700	\$ 1,746,826
August 31, 2000	1,821,761	1,775,123
September 30, 2000	1,845,691	1,789,215
October 31, 2000	1,848,482	1,803,563
November 30, 2000	1,839,437	1,800,964
December 31, 2000	1,844,933	1,805,080
January 31, 2001	1,314,561	1,291,360
February 28, 2001	1,292,246	1,238,133
March 31, 2001	1,691,362	1,644,624
April 30, 2001	1,131,575	1,091,920
May 31, 2001	1,089,350	1,059,564
June 30, 2001	<u>1,086,780</u>	<u>1,045,426</u>
Average balance	<u>\$ 1,549,823</u>	<u>\$ 1,507,650</u>

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-10: Inadequate Cash Management Procedures (Prior Report Finding Number SA-00-10)(First Reported 1987)...(Concluded):

Following is an analysis of the average cash needs of all programs:

	Tenant-Based Cluster		Project-Based Cluster	
	<u>Voucher</u>	<u>Certificate</u>	<u>Moderate I</u>	<u>Moderate II</u>
Total Expenditures	\$4,979,165	\$176,096	\$ 761,711	\$ 431,391
Divided by 12 months	<u>12</u>	<u>12</u>	<u>12</u>	<u>12</u>
Average Cash Needs	<u>\$ 414,930</u>	<u>\$ 14,675</u>	<u>\$ 63,476</u>	<u>\$ 35,949</u>
Total Monthly Expenditures for the four Programs			\$ 529,030	
Combined average balance for the year			<u>1,507,650</u>	
Average monthly cash on hand in excess of needs			<u>\$ 978,620</u>	

The above conditions are the result of inadequate cash forecasting procedures since the Municipality has requested and received federal funds in excess of its immediate needs since there is cash on hand to cover future needs. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs on the excess cash on hand, which would be paid from local funds.

The 24 CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time elapsing between the receipt of funds and their disbursement for expenditures.

Questioned Costs: \$51,866, representing interest on the excess balance at the federal funds rate.

Recommendation:

The Municipality should use cash on hand before requesting additional funds.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-11: Amounts Due from General Fund (Prior Report Finding Number SA-00-11)(First Reported 1992):

The Municipality has not reimbursed the federal program for the federal funds used to finance the general fund's activities. As of June 30, 2001, a balance of \$1,031,152 remained outstanding for funds that were transferred to the Municipality's general fund in prior years. The transfer represents an instance of noncompliance with an executive order issued by the Mayor in August 1992.

The 24 CFR 570.200 establishes the various allowable activities to be financed with federal funds. However, none of the sections under this Title allows the transfer of federal funds to finance the activities of the general fund.

This condition permits the financing of the general fund activities with federal funds and places additional financial limitation on the performance of the activities approved under the federal grant. Accordingly, the continued failure to reimburse the federal program may expose the Municipality to the assessment of interest costs and penalties in relation to the use of these funds.

Questioned Costs: None since this amount has been included as a questioned cost in previous years Single Audit reports.

Recommendation:

The general fund must reimburse the federal program the amount owed as soon as possible. In addition, the Municipality should not permit transfers of federal funds to finance activities not approved by the Federal grantor and that are not in accordance with the grant agreements.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-12: Ineffective Property Management Controls (Prior Report Finding Number SA-00-12)(First Reported 2000):

The Municipality is not reconciling on a timely basis its fixed assets balances according to the physical inventory observation with the accounting records. We noted that the property physical inventory compilation was not summarized and/or compared to the balance in the General Ledger. In addition, there were no periodic reviews of the use of program equipment to ensure that these are being used for program-related purposes. Moreover, we noted that the results from the physical inventory compilation did not show evidence that management examined or reviewed the document.

This situation is mainly caused by the lack of appointing personnel to perform proper inventory reviews and reconciliation procedures by the Municipality.

24 CFR 85.32©,(4),(d), (3), and (4), state that a control system must be developed to ensure adequate safeguards to prevent loss, damage or theft of the property. Any loss or theft shall be investigated and adequate maintenance procedures must be developed to keep the property in good condition.

The continued failure to establish internal controls over compliance with the above requirements exposes the Municipality to unauthorized use or disposition of the program's property equipment. In addition, this may result in the carry forward of material misstatements from prior years not previously identified.

Questioned Costs: None.

Recommendation:

The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-13: Inadequate Documentation of Participant Files (First Reported 1986):

The Municipality's system of internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 cluster programs we noted that the Municipality was not maintaining the required documents and information in each file to support participant's eligibility as required by Section 8 Program regulations. During our tests of eligibility requirements we tested twenty-five (25) participant files and noted the following exceptions:

Contract #	Monthly Amount	1	2	3	4
Vouchers 00-052-2V	\$ 475	X			
Vouchers 98-104-2V	375	X			
Vouchers 99-210-2V	398	X			
Vouchers 99-308-V	312	X			
Vouchers 00-506-2V	425	X	X		
Vouchers 00-575-2V	380	X	X		
Vouchers 90-936-1V	450	X			
Vouchers 00-1015-2V	425	X			
Vouchers 00-1077-2V	400	X			
Vouchers 99-254-2V	413	X			
Vouchers 97-1378-1V	300		X	X	
Vouchers 92-1089-1V	365			X	X
Total instances of noncompliance		10	3	2	1
Sample size		25	25	25	25
Percentage of noncompliance		40%	12%	8%	4%
Questioned Costs		None	\$ 13,260	\$ 4,380	None

3. File did not include the "Crédito por Utilidades" Worksheet.
4. File did not include the HAP contract and Addendum, resulting in questioned costs.
5. File did not include photo of the family composition, resulting in questioned costs.
4. File did not include good conduct certificate.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-13: Inadequate Documentation of Participant Files ... (Concluded):

All of the above matters occur because the Municipality's system of internal control relating to the compliance requirements is not effectively identifying and correcting these matters through the proper review of participant files for completeness of documents, signatures and information, as well as for their accuracy. The current procedures do not effectively reduce the risk of ineligible participants receiving program benefits.

24 CFR Sections 882-113, 882-209, 882-214, 882-412, 882-514, 882-515, 882-518, 883-711, 883-704, and 889-103 establish that the PHA is required to accept applications for admission to the projects, determine whether the applicants are initially eligible, and on a yearly basis, reexamine family income, composition, and contribution to rent and utilities. In addition, the Municipality should verify that the information submitted by participants is reliable.

The sample tested of 25 participant files represent approximately 3% of the universe of 966 program participants as of June 30, 2001. The dollar value of the sample selected amounted to \$116,964, which represent 2% of the value of the total of approximately \$5.2 million received for the year ended June 30, 2001.

Questioned Costs: \$17,640 – Which was determined by computing the total annual payment for each of the contracts that have been found in noncompliance.

Recommendation:

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.

MUNICIPALITY OF PONCE, PUERTO RICO

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO FEDERAL PROGRAMS
YEAR ENDED JUNE 30, 2001**

SECTION 8 – TENANT-BASED CLUSTER

FINDING NOT REPEATED FROM PRIOR AUDIT

- Finding Number SA-00-09: Bank Reconciliations Not Properly Signed by Finance Director and Subdirector – Our procedures for the current audit did not indicate a lack of compliance.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – PROJECT-BASED CLUSTER LOWER INCOME HOUSING ASSISTANCE PROGRAM – SECTION 8 MODERATE REHABILITATION I & II (CFDA # 14.856)

PROGRAM DESCRIPTION

The Moderate Rehabilitation Program assists low income families in affording decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low income families. The Public Housing Authority (PHA) and the owner execute an Agreement to Enter into Housing Assistance Payments Contract under which the owner agrees to rehabilitate the unit to be subsidized and the PHA agrees to subsidize the units upon satisfactory completion of rehabilitation. Upon completion of the rehabilitation, the PHA and the owner execute a HAP contract. The PHA refers interested eligible families on its Section 8 waiting list to the owner to fill vacancies in moderate rehabilitation units.

The Moderate Rehabilitation Program assistance is considered a project-based subsidy because the assistance is tied to specific units under an assistance contract with the owner for a specified term. A family that moves from a unit with project-based assistance does not have any right to continued assistance.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to these federal financial assistance programs.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – PROJECT-BASED CLUSTER LOWER INCOME HOUSING ASSISTANCE PROGRAM – SECTION 8 MODERATE REHABILITATION I & II

Finding Number SA-01-14: Inadequate Cash Management Procedures (Prior Report Finding Number SA-00-13)(First Reported 1987):

The Municipality's internal controls over compliance with the cash management requirements of the federal program are not effective since it is holding excessive cash balances in its bank accounts. During our audit of the bank reconciliations of the Programs' cash accounts, (which is used by the Programs and pools the funds received under the Tenant-Based Cluster and the Project-Based Cluster) we noted that the average balance on hand and in books significantly exceeded the average cash need of all Programs. Following is a list of the average balances of cash on hand for the Programs, as well as during the fiscal year:

<u>Month Ended</u>	<u>Bank Balance</u>	<u>Book Balance</u>
July 31, 2000	\$ 1,791,700	\$ 1,746,826
August 31, 2000	1,821,761	1,775,123
September 30, 2000	1,845,691	1,789,215
October 31, 2000	1,848,482	1,803,563
November 30, 2000	1,839,437	1,800,964
December 31, 2000	1,844,933	1,805,080
January 31, 2001	1,314,561	1,291,360
February 28, 2001	1,292,246	1,238,133
March 31, 2001	1,691,362	1,644,624
April 30, 2001	1,131,575	1,091,920
May 31, 2001	1,089,350	1,059,564
June 30, 2001	<u>1,086,780</u>	<u>1,045,426</u>
Average balance	<u>\$ 1,549,823</u>	<u>\$ 1,507,650</u>

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – PROJECT-BASED CLUSTER LOWER INCOME HOUSING ASSISTANCE PROGRAM – SECTION 8 MODERATE REHABILITATION I & II

Finding Number SA-01-14: Inadequate Cash Management Procedures (Prior Report Finding Number SA-00-13)(First Reported 1987)...(Concluded):

Following is an analysis of the average cash needs of all programs:

	Tenant-Based Cluster		Project-Based Cluster	
	Voucher	Certificate	Moderate I	Moderate II
Total Expenditures	\$4,979,165	\$ 176,096	\$ 761,711	\$431,391
Divided by 12 months	12	12	12	12
Average Cash Needs	\$ 414,930	\$ 14,675	\$ 63,476	\$ 35,949
Total Monthly Expenditures for the four Programs			\$ 529,030	
Combined average balance for the year			1,507,650	
Average monthly cash on hand in excess of needs			\$ 978,620	

The above exceptions are the result of inadequate cash forecasting procedures since the Municipality has requested and received federal funds in excess of its immediate needs since there is cash on hand to cover future needs. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs on the excess cash on hand, which would be paid from local funds.

24 CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time elapsing between the receipt of funds and their disbursement for expenditures.

Questioned Costs: None, already questioned in finding SA-01-10.

Recommendation:

The Municipality should use cash on hand before requesting additional funds.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – PROJECT-BASED CLUSTER LOWER INCOME HOUSING ASSISTANCE PROGRAM – SECTION 8 MODERATE REHABILITATION I & II

Finding Number SA-01-15: Inadequate Documentation of Participant Files (First Reported 1986):

The Municipality's internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 cluster programs we noted that the Municipality was not maintaining the required documents and information in each file to support participant's eligibility as required by Section 8 Program regulations. During our tests of eligibility requirements we tested twenty-five (25) participant files and noted the following exceptions:

Contract #	Monthly Amount	1	2	3	4
Moderate II 01-013-2MRF	\$ 502	X			
Moderate I 97-030-2MRD	503		X	X	
Moderate I 92-038-MRD	503			X	
Moderate I 99-068-2MRD	503				X
Total instances of noncompliance		1	1	2	1
Sample Size		25	25	25	25
Percentage of noncompliance		4%	4%	8%	4%
Questioned Costs		\$ 6,024	None	\$ 12,072	\$ 6,036

1. File did not include the lease addendum, resulting in questioned costs.
2. File did not include the "Certificación y Solicitud para Pago de Subsidio".
3. File did not include Housing Assistance Payment Contract.
4. File did not include the annual inspection form, resulting in questioned costs.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

SECTION 8 – TENANT-BASED CLUSTER

Finding Number SA-01-15: Inadequate Documentation of Participant Files ... (Concluded):

All of the above exceptions occurred because the Municipality's internal controls relating to program compliance are not effectively identifying and correcting these matters through the review of participant files for completeness of documents, signatures and information, as well as for their accuracy. The current procedures do not effectively reduce the risk of ineligible participants receiving program benefits.

24 CFR Sections 882-113, 882-209, 882-214, 882-412, 882-514, 882-515, 882-518, 883-711, 883-704, and 889-103 establish that the PHA is required to accept applications for admission to the projects, determine whether the applicants are initially eligible, and on a yearly basis, reexamine family income, composition, and contribution to rent and utilities. In addition, the Municipality should verify that the information submitted by participants is reliable.

The sample tested of 25 participant files represent approximately 14% of the universe of 181 program participants as of June 30, 2001. The dollar value of the sample selected amounted to \$158,268, which represent 3% of the total of approximately \$5.2 million received for the year ended June 30, 2001.

Questioned Costs: \$24,132 – Which was determined by computing the total annual payment for each of the contracts that have been found in noncompliance.

Recommendation:

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances .

MUNICIPALITY OF PONCE, PUERTO RICO

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO FEDERAL PROGRAMS
YEAR ENDED JUNE 30, 2001**

**SECTION 8 – PROJECT-BASED CLUSTER
LOWER INCOME HOUSING ASSISTANCE PROGRAM –
SECTION 8 MODERATE REHABILITATION I & II**

FINDING NOT REPEATED FROM PRIOR AUDIT

- Finding Number SA-00-14: Bank Reconciliations Not Properly Signed by Finance Director and Subdirector – Our audit procedures for the current year did not indicate a lack of compliance.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HUD DISASTER RECOVERY INITIATIVE (GRANT NO. B-98MU-72-0003)

PROGRAM DESCRIPTION

HUD's Disaster Recovery Initiative helps communities impacted by disasters receiving Presidential declarations. HUD Disaster Recovery funds are intended to support the activities of other Federal agencies and cannot be used for activities reimbursable or for which funds are made available by the Federal Emergency Management Agency (FEMA), the Small Business Administration (SBA), or the U.S. Army Corps of Engineers (USACE).

An objective of the program is the redevelopment of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, especially for persons of low and moderate income.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to the Public Assistance federal financial assistance program.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HUD DISASTER RECOVERY INITIATIVE

Finding Number SA-01-16: Inadequate Cash Management Procedures:

The Municipality's internal controls relating to compliance with the cash management requirements of the federal program are not effective since they are not minimizing the time elapsed between the receipt and final disbursement of funds. We selected 10 cash requisitions, totaling \$863,056, out of 29 for the year, totaling \$1,499,059 and noted that the Municipality is holding funds in excess of three-days worth of payments as follows:

<u>Amount Requested</u>	<u>Date Received</u>	<u>Disbursed within 4 - 10 days</u>	<u>Disbursed within 11 - 30 days</u>	<u>Total Noncompliance</u>
\$ 5,153	September 11, 2000	\$ 5,153		\$ 5,153
5,466	November 15, 2000		\$ 5,466	5,466
15,477	January 18, 2001	15,477		15,477
<u>13,138</u>	January 31, 2001	<u>13,138</u>	<u>-</u>	<u>13,138</u>
<u>\$39,234</u>		<u>\$ 33,768</u>	<u>\$ 5,466</u>	<u>\$ 39,234</u>

The above exceptions are the result of inadequate cash forecasting procedures since the Municipality has requested and received federal funds in excess of its immediate needs. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs on the excess cash on hand, which would be paid from local funds.

24 CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time elapsing between the receipt of funds and the disbursements for expenditures.

The continued occurrence of this condition may expose the Municipality to the assessment of interest costs over the excess cash on hand.

Questioned Costs: \$2,079, representing interest on the excess balance at the federal funds rate.

Recommendation:

The Municipality should modify the cash forecasting process of the program by establishing a system to forecast the cash needs for its immediate needs, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HUD DISASTER RECOVERY INITIATIVE

Finding Number SA-01-17: Noncompliance with the Period of Availability of Federal Funds:

The Municipality is not obligating federal funds within the required obligation period established by federal regulations. Our test of expenditures revealed that several transactions were made after the required obligation period as follows:

<u>Number</u>	<u>Voucher Date</u>	<u>Expenditure Amount</u>	<u>Description</u>	<u>Obligation Date</u>	<u>Obligation Due Date</u>
01-38-068	April 9, 2001	\$ 5,853	Construction materials	March 12, 2001	December 1, 2000
02-38-016	August 16, 2001	3,480	Construction materials	March 30, 2001	December 1, 2000
01-38-087	May 22, 2001	18,854	Construction materials	February 13, 2001	December 1, 2000
01-38-088	May 22, 2001	15,917	Construction materials	March 20, 2001	December 1, 2000
Total		<u>\$ 44,104</u>			

The above condition occurred because the Municipality has not taken the appropriate steps to ensure federal fund disbursements are made with the period of availability.

The Special Contract Conditions Applicable to the Use of HUD Disaster Recovery Initiative Funds establish that all Disaster Recovery Initiative Funds must be obligated within twenty-four (24) months of the effective date of the grant agreement.

The failure to obligate such funds within the allowed time period may result cost disallowances by the federal grantor.

Questioned Cost: \$44,104.

Recommendation:

The Municipality should improve its internal control procedures to ensure federal funds are obligated within the required time period.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HUD DISASTER RECOVERY INITIATIVE

Finding Number SA-01-18: Ineffective Controls Over Preparation and Submission of Federal Financial Reports:

The Municipality does not have effective internal controls to ensure the accurate preparation and timely submission of federal financial reports of the Program. We noted the following differences:

	<u>Line</u>	<u>Amount per Books</u>	<u>Amount per Report</u>	<u>Difference</u>
<u>Performance Reports:</u>				
<u>Quarter Ended</u>				
September 30, 2000	Total cumulative expenditures	\$ 948,028	\$ 999,203	\$ (51,175)
<u>Quarter Ended</u>				
December 31, 2000	Total cumulative expenditures	1,140,457	1,154,281	(13,824)
<u>Quarter Ended</u>				
March 30, 2001	Total cumulative expenditures	1,872,017	1,885,711	(13,694)
<u>Quarter Ended</u>				
June 30, 2001	Total cumulative expenditures	2,823,315	2,896,784	(73,469)

The exceptions described above result from the preparation of federal financial reports without ensuring that the amounts reported agree with the underlying accounting records, and the failure of management to detect these differences during their review and approval of the federal financial reports. The continued failure to file accurate financial reports may result in actions by the federal grantor against the Municipality, such as grant payment withholdings resulting from the misstatement of the financial performance of the program.

The 24 CFR 85.20 (b)(1) establishes that federal funds recipients shall have a financial management system that will provide for the accurate, current and complete disclosure of the financial results of federally assisted activities.

The continued occurrence of this situation may result in sanctions by the federal grantor because the information provided in the performance reports does not allow them to adequately monitor and evaluate the Program's financial performance.

Questioned Costs: None.

Recommendation:

The reviewer of these reports should ensure that amounts reported agree with the underlying accounting records before submission to the federal grantor. In addition, whenever significant adjustments or modifications are deemed necessary, the Municipality should amend submitted reports and include the appropriate supporting explanations.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

WELFARE-TO-WORK GRANTS TO STATES AND LOCALITIES ("WtW") (CFDA # 17.253)

PROGRAM DESCRIPTION

The objective of the Welfare-to-Work (WtW) grants to States and local communities is to provide funds for transitional employment assistance to move hard-to-employ Temporary Assistance Needy Families ("TANF") recipients with significant employment barriers and certain noncustodial parents into unsubsidized jobs offering long-term employment opportunities. These grants are intended to provide welfare recipients with job placement services, transition employment, and job retention and support services to achieve the ultimate goal of long-term unsubsidized employment and economic self-sufficiency. Funds may be used to help move eligible individuals into jobs by: (1) job creation through public or private sector wage subsidies; (2) on-the-job training; contracts with public or private providers of job readiness, job placement, and post-employment services; (3) job vouchers for similar services; (4) community service or work experience; (5) or job retention and supportive services (if such services are not otherwise available).

At least half of the funds distributed by formula to local areas must be based on a Service Delivery Area's proportion of the State population in high poverty areas. Not more than half may be distributed based on two additional factors: (1) the number of adults receiving TANF assistance for 30 months or more and (2) the number of unemployed in the SDA.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to the Welfare-to-Work financial assistance program.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

WELFARE-TO-WORK PROGRAM

Finding Number SA-01-19: Inadequate Cash Management Procedures:

The Municipality's internal controls relating to compliance with the cash management requirements of the federal program are not effective since they are not minimizing the time elapsed between the receipt of funds and its final disbursement for payment. We selected five cash requisitions totaling approximately \$482,000, out of 11 requisitions made during the year totaling approximately \$987,000 and noted that all of them were made for an amount in excess of the Program's immediate needs.

The above exception occurred because the Program's cash requisitions are made to cover the total disbursements for the month and not for its immediate needs. The Program has adopted this approach due to the delay of the Technological Occupational Education Council (the "Council") in disbursing the funds requested by the Program.

The Welfare to Work Fiscal and Cash Management Guide issued by the Council establishes that the Program's cash on hand balance shall not exceed a 5-day need. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs relating to the excess cash on hand, which could be paid from local funds.

Questioned Costs: None.

Recommendation:

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by the Welfare to Work regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt or within the next five business days.

MUNICIPALITY OF PONCE, PUERTO RICO

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO FEDERAL PROGRAMS
YEAR ENDED JUNE 30, 2001**

WELFARE-TO-WORK PROGRAM

FINDINGS NOT REPEATED FROM PRIOR AUDIT

- Finding Number SA-00-18: Bank Reconciliations not Properly Signed by Finance Director and Subdirector – Our audit procedures for the current year did not indicate a lack of compliance.
- Finding Number SA-00-19: Inadequate Property Management Procedures – Our audit procedures for the current year did not indicate a lack of compliance.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

WORKFORCE INVESTMENT ACT ("WIA") (CFDA # 17.255)

PROGRAM DESCRIPTION

The Workforce Investment Act of 1998 (WIA) reforms Federal job training programs and creates a new, comprehensive workforce investment system. The reformed system is intended to be customer-focused, to help Americans access the tools they need to manage their careers through information and high quality services, and to help U.S. companies find skilled workers. The cornerstone of the new workforce investment system is One-Stop service delivery, which unifies numerous training, education and employment programs into a single, customer-friendly system in each community so that the customer has access to a seamless system of workforce investment services.

There are three program categories under Subtitle B of Title I: Adult; Dislocated Worker; and Youth Activities. Programs for adults and dislocated workers seek to improve employment, retention, and earnings of WIA participants and increase their educational and occupational skill attainment, thereby improving the quality of the workforce, reducing welfare dependency, and enhancing national productivity and competitiveness. Subtitle B Youth activities seek to increase the attainment of basic skills, work readiness or occupational skills, and secondary diplomas or other credentials.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to the Workforce Investment Act financial assistance program.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

WORKFORCE INVESTMENT ACT ("WIA") (CFDA # 17.255)

Finding Number SA-01-20: Inadequate Cash Management Procedures:

The Municipality's internal controls relating to compliance with the cash management requirements of the federal program are not effective since they are not minimizing the time elapsed between the receipt of funds and final disbursement for payment. We selected 16 cash requisitions totaling approximately \$2,609,000, out of 38 requisitions made during the year totaling approximately \$7,679,000 and noted that all of them were made for an amount in excess of the Program's immediate needs.

The above condition occurred because the Program's cash requisitions are made to cover the total disbursements for the month and not for its immediate needs. The Program has adopted this approach due to the delay of the Technological Occupational Education Council (the "Council") in disbursing the funds requested by the Program.

The WIA Fiscal and Cash Management Guide issued by the Council establishes that the Program's cash on hand balance shall not exceed a 5-day need. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs relating to the excess cash on hand, which could be paid from local funds.

Questioned Costs: None.

Recommendation:

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by the WIA regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt or within the next five business days.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

ADMINISTRATION FOR CHILDREN, YOUTH AND FAMILIES ("HEAD START") (CFDA # 93.600)

PROGRAM DESCRIPTION

The objectives of the Head Start Program are to provide comprehensive health, educational, nutritional, social, and other services to economically disadvantaged pre-school children so that the children will attain overall social competence. Parents also participate in various decision-making processes related to the operation of the program.

Grants are made by the Administration for Children, Youth and Families, ("ACYF"), to community action agencies, limited purpose agencies and units of local government who operate the program or assign the activity to one or more delegate agencies identified in the grant application. Each grantee and delegate agency generally operates the program through several locations.

The following findings and recommendations arise from our tests of compliance and internal control over compliance with requirements applicable to the Head Start federal financial assistance program.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-21: Ineffective Controls Over Preparation and Submission of Federal Financial Reports (Prior Report Finding Number SA-00-23)(First Reported 1986):

The Municipality does not have effective system of internal control to ensure the accurate preparation and timely submission of federal financial reports of the Program. We noted the following differences:

<u>Federal Cash Transactions Reports:</u>	<u>Line</u>	<u>Amount per Books</u>	<u>Amount per Report</u>	<u>Difference</u>
<u>Quarter Ended</u>				
September 30, 2000	Net disbursements	\$ (2,209,573)	\$ (1,832,163)	\$ (377,410)
	Cash on hand - end of period	(435,107)	(57,697)	(377,410)
<u>Quarter Ended</u>				
December 31, 2000	Cash on hand - beginning of period	(435,107)	(57,697)	(377,410)
	Total cash available	1,853,632	2,231,042	(377,410)
	Cash on hand - end of period	(632,472)	(255,062)	(377,410)
<u>Quarter Ended</u>				
March 30, 2001	Cash on hand - beginning of period	(632,472)	(255,062)	(377,410)
	Total cash available	2,472,964	2,850,374	(377,410)
	Cash on hand - end of period	(211,907)	165,503	(377,410)
<u>Quarter Ended</u>				
June 30, 2001	Cash on hand - beginning of period	(211,907)	165,503	(377,410)
	Total cash available	1,961,366	2,338,776	(377,410)
	Net disbursements	(2,202,348)	(2,180,193)	(22,155)
	Cash on hand - end of period	(240,982)	158,584	(399,566)
<u>Financial Status Reports:</u>				
<u>Six Months Ended</u>				
June 30, 2001	Federal Outlays	509,320	379,094	130,226
	Cummulative Outlays	11,394,555	11,264,329	130,226
	Unobligated Balance	268,895	398,961	(130,066)

45 CFR 92.41-(b)(3) requires federal fund recipients to periodically monitor the performance of grant-supported activities to assure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved by the preparation of federal financial reports. To achieve these goals, management shall prepare accurate and timely federal financial reports. In addition, Common Rule, Paragraph 20-(b)(1) establishes that federal fund recipients shall have a financial management system that will provide for the accurate, current and complete disclosure of the financial results of financially assisted activities. The same shall be the underlying record to support the amounts included in the financial reports submitted to federal grantor. Also, 45 CFR 74.74 states that the Federal Cash Transaction Report must be submitted no later than 45 working days following the end of each quarter.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-21: Ineffective Controls Over Preparation and Submission of Federal Financial Reports ...(Concluded):

The conditions described above result from the preparation of federal financial reports without ensuring that the amounts reported agree with the underlying accounting records, and the failure of management to detect these differences during their review and approval of the federal financial reports. The continued failure to file accurate financial reports may result in actions by the federal grantor against the Municipality, such as grant payment withholdings resulting from the misstatement of the financial performance of the program.

Questioned Costs: None.

Recommendation:

The reviewer of these reports should ensure that amounts reported agree with the underlying accounting records before submission to the federal grantor. Also, the Municipality should implement a reporting calendar to keep all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the required reporting deadlines.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-22: Failure to Meet Full Enrollment Level (Prior Report Finding Number SA-00-24)(First Reported 1986):

The Municipality is not achieving the necessary enrollment levels for the Program. The Program did not maintain a full enrollment for the academic year ended December 31, 2000 as required by the funding agreement with the Federal grantor. The total funded (required) enrollment and actual enrollment were as follows:

Total funded enrollment for the year (required enrollment)	1,580
Total actual enrollment for period ended December 31, 2000	<u>1,486</u>
Enrollment not met	<u>94</u>

This exception results because the Municipality is requesting funding for the enrollment of 1,580 participants, while available facilities can only hold a maximum of 1,504 participants. In addition full enrollment is not achieved at all locations.

The failure to comply with the required enrollment level may result in cost disallowances by the federal grantor since cost per child served exceeds the budgeted cost per child based on the funded enrollment approved.

45 CFR Part 1305, establishes that enrollment is an on-going process, and maintenance of a full enrollment level depends upon the success of the recruitment program. The Head Start Program must maintain an enrollment level equal to its funded slots and must try to fill vacancies as soon as they occur in order to maintain full enrollment. All vacancies must be filled within 30 calendar days.

Questioned Costs: \$150,502 – Calculated as follows:

Approved grant for calendar year ended December 31, 2000, net of administrative costs	\$ 8,933,249	
Funded enrollment per proposal	<u>÷ 1,580</u>	
Average budgeted direct cost per participant		\$ 5,654
Actual expenditures incurred under the grant-year ended December 31, 2000, net of administrative costs	\$ 8,552,279	
Actual enrollment	<u>÷ 1,486</u>	
Actual average direct cost per participant		<u>5,755</u>
Excess direct cost per participant		\$ 101
Actual participants		<u>× 1,486</u>
Questioned costs		<u>\$ 150,086</u>

MUNICIPALITY OF PONCE, PUERTO RICO
FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO FEDERAL PROGRAMS
YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-22: Failure to Meet Full Enrollment Level (Prior Report Finding Number SA-00-24)(First Reported 1986)...(concluded):

Recommendation:

The Municipality should obtain additional facilities in order to be able to meet the full enrollment level or reduce the funding requirement, when requesting funds. Also, the Municipality should consider evaluating the effectiveness of the enrollment process at those locations where full enrollment is not met, and either close the facilities or change location to an area where full enrollment can be met.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-23: Inadequate Cash Management Procedures (Prior Report Finding Number SA-00-25)(First Reported 1986):

The Municipality's internal controls relating to compliance with the cash management requirements of the federal program are not effective since they are not minimizing the time elapsed between the receipt and final disbursement of funds. We selected 13 cash requisitions, totaling \$3,220,449, out of 38 for the year, totaling \$9,739,627 and noted that the Municipality is holding funds in excess of three-days worth of payments as follows:

<u>Amount Requested</u>	<u>Date Received</u>	<u>Disbursed within 4 - 10 days</u>	<u>Disbursed within 11 - 30 days</u>	<u>Total Noncompliance</u>
\$ 594,877	August 11, 2000	\$ 31,353	\$ 237,789	\$ 269,142
432,909	September 6, 2000	197,998	-	197,998
440,146	October 10, 2000	19,858	-	19,858
<u>\$ 1,467,932</u>		<u>\$ 249,209</u>	<u>\$ 237,789</u>	<u>\$ 486,998</u>

The above conditions are the result of inadequate cash forecasting procedures since the Municipality has requested and received federal funds in excess of its immediate needs. The continued occurrence of this condition may expose the Municipality to the assessment of interest costs on the excess cash on hand, which would be paid from local funds.

The 45 CFR 92.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time elapsing between the receipt of funds and the disbursements for expenditures. For this program, the cash on hand should not exceed three-day worth of expenditures.

The continued occurrence of this condition may expose the Municipality to the assessment of interest costs over the excess cash on hand.

Questioned Costs: \$25,810, representing interest on the excess balance at the federal funds rate.

Recommendation:

The Municipality should modify the cash forecasting process of the program by establishing a system to forecast the cash needs for the next three days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-24: Failure to Meet the Minimum Required Average Daily Attendance Level (Prior Report Finding Number SA-00-26)(First Reported 1995):

The Municipality does not have effective internal controls over compliance with the requirement to obtain and maintain the required participant attendance level. We selected 19 out of 77 Head Start Centers and for each center we selected one month for the verification of the daily attendance rate. The Municipality did not achieve the required minimum daily attendance rates for 15 out of the 19 Head Start Centers selected for testing. The average daily attendance rate for such months were as follows:

Center	Month	Days Center was In Operation	Enrollment	Average Daily Attendance Rate	Required Attendance Rate
CAPITANEJO 2	October	19	20	79%	85%
CERRILLO HOYOS 1	November	17	20	82%	85%
CERRILLO HOYOS 2	January	14	19	80%	85%
JARD. DEL CARIBE 1	February	19	19	80%	85%
JARD. DEL CARIBE 2	March	21	20	76%	85%
LIRIOS DEL SUR 1	May	14	18	70%	85%
LIRIOS DEL SUR 2 A	April	19	20	77%	85%
LIRIOS DEL SUR 2 B	September	18	20	81%	85%
MAGUEYES 1	October	19	20	84%	85%
MAGUEYES 2	December	17	19	78%	85%
PÁMPANOS 1	January	16	18	82%	85%
PÁMPANOS 2	February	19	19	82%	85%
PONCE HOUSING	March	21	17	82%	85%
PUNTA DIAMANTE 1	May	11	17	52%	85%
PUNTA DIAMANTE 2	April	19	19	76%	85%

In addition, we selected eight children with four or more consecutive unexcused absences and examined whether appropriate action was taken by the program and documented in the participant's file. For five out of the eight children selected for testing, the participants' file did not include documentation regarding the family support procedures performed by the Program.

The failure to meet this requirement results from the failure to assess the reasons for participant absenteeism, and for the need to provide additional incentives to increase and maintain the attendance level.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-24: Failure to Meet the Minimum Required Average Daily Attendance Level ... (Concluded):

The Head Start Enrollment and Attendance Policies, Federal Register, Vol. 44, No. 214, requires a minimum average daily attendance of 85%. In addition, 45 CFR 92.41-(b)(3) requires federal fund recipients to periodically monitor the performance of grant-supported activities to assure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved.

The continued failure to meet the required attendance levels may result in cost disallowances or in the reduction of future grant awards because this situation may be an indicator of needed improvements in service delivery and consequently, the overall program objectives may not be consistently met. In addition, federal funds spent per participant may be substantially higher than the proposed cost per participant, thus exposing the Municipality to cost disallowances as a result of excess costs incurred in relation to the participants enrolled.

Questioned Costs: None determined because we already assessed questioned costs in Finding Number SA-01-22 for not meeting minimum enrollment level.

Recommendation:

The program should analyze the specific causes for absenteeism. Such analysis shall include, but not be limited to, a study of the absence pattern for each child and hold meetings with parents/guardians to provide orientation as to the benefits of daily attendance. In addition, the program should initiate the corresponding action based on the results of the analysis.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HEAD START PROGRAM

Finding Number SA-01-25: Noncompliance with the Davis Bacon Act:

The Municipality does not have effective internal controls over compliance with the requirement to ensure that all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds are paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 276a to 276a-7). For one construction project selected for testing we noted that a written contract including the prevailing wage rate clauses was not prepared.

The above situation occurred because the program's personnel followed the procurement guidelines outlined in the Autonomous Municipalities Law. Such Law requires that construction projects under \$40,000 will be subject to the process of informal bids. As part of this process the Municipality is only required to obtain three quotations from different suppliers.

The Davis Bacon Act requires that all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 276a to 276a-7).

The continued failure to implement internal controls and ensure compliance with the above requirement may expose the Municipality to cost disallowances .

Questioned Costs: \$76,305

Recommendation:

The Municipality should prepare written contracts including the prevailing wage rate clauses for all construction projects in excess of \$2,000 and financed by Federal assistance funds and ensure that contractors and subcontractors are paid the prevailing wage rates.

MUNICIPALITY OF PONCE, PUERTO RICO

**FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO FEDERAL PROGRAMS
YEAR ENDED JUNE 30, 2001**

HEAD START PROGRAM

FINDING NOT REPEATED FROM PRIOR AUDIT

- Finding Number SA-00-27: Ineffective Reconciliation and Follow-up Procedures – Our audit procedures for the current year did not indicate a lack of compliance.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HIV CLUSTER - HIV EMERGENCY RELIEF PROJECT AND FORMULA GRANTS (RYAN WHITE) (CFDA #93.914)

PROGRAM DESCRIPTION

The objective of the HIV Emergency Relief Project and Formula Grant Program (Ryan White) is to provide emergency financial assistance to localities that are disproportionately affected by the Human Immunodeficiency Virus (HIV) epidemic to develop, organize and operate programs that provide an effective, appropriate and cost-efficient system for the delivery of essential services to individuals and families with HIV disease.

Funds received under a grant are to be used to provide direct financial assistance for the purpose of delivering or enhancing HIV - related outpatient and ambulatory health and support services, including case management and comprehensive treatment services, for individuals and families with HIV disease; and inpatient case management services that prevent unnecessary hospitalization or that expedite discharge, as medically appropriate, from inpatient facilities.

The Program priorities are the following:

Primary Medical Care - Medication Treatments: this service is expected to increase the availability of medication treatments to the existing HIV/AIDS population. It consists mainly of providing medications, primarily retrovirals, to HIV patients.

Home Care: provide care to patients in a home environment.

Laboratory/Diagnostic Services: aimed to provide identified HIV patients with follow-up laboratory procedures and tests. It is intended to expand the availability of lab tests to patients in order to facilitate the delivery of adequate medication.

Home Delivery Meals: a supplemental feeding program that will help the patients to maintain an appropriate level of nutrition by offering daily home delivered meals.

Case Management: maximize the utilization of trained personnel who will take a meaningful interest in the progress of the patient and who will continually aid the patient and family members in scheduling and receiving services, in making adjustments to daily life, and in facing the uncertainties of the disease with a considerable amount of personal support from knowledgeable professionals.

Transportation: consists of providing transportation services to patients.

The following findings and recommendations arise from our tests of compliance and internal control over compliance requirements applicable to the Ryan White federal financial assistance program.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HIV EMERGENCY RELIEF PROJECT AND FORMULA GRANTS (RYAN WHITE)

Finding Number SA-01-26: Lack of Formal Accounting Records to Support Federal Financial Reports (Prior Single Audit Finding Number SA-00-28)(First Reported 1999):

The Municipality does not maintain a self-balancing set of accounts or any type of formal accounting records to account for the transactions and payments of the Program.

The program does not maintain a formal set of books and accounts. Instead, accounting and reporting is supported by spreadsheet-based records. Therefore, the Program does not have current accurate and complete information with regards to the programs' assets, liabilities, obligations, or unobligated balances, nor is there proper accountability and internal control at program level for the assets owned by the Program. In addition, there is no accurate comparison of actual expenditures against budgeted amounts at the account level.

This has occurred because the Municipality has exercised inadequate oversight over the accounting functions of this Program by not requiring the establishment of a separate set of books for this fund. Instead, the Municipality has permitted the maintenance of informal accounting records, such as spreadsheets, to support the accountability of a major federal program.

The 45 CFR 92.20(b)(2) establishes that grantees and subgrantees 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 subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Furthermore, Section 20(b)(3) establishes that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Also, Section 20(b)(4) establishes that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.

Failure to maintain adequate accounting records may result in transactions not being accounted for, in the recording of unauthorized transactions, the unauthorized use or disposition of program assets or in the preparation of inaccurate or incomplete federal financial reports. Therefore, any amounts not used in accordance with program guidelines, or any unauthorized disposition of assets may result in cost disallowances. Furthermore, failure to compare actual expenditures with approved budget at the account level may result in cost disallowances for exceeding approved budgets.

Questioned Costs: None.

Recommendation:

The Municipality must establish a self-balancing set of accounts for the program and require the accurate and complete maintenance of a full set of accounting records to provide proper accountability over program assets, as well as to enhance the internal controls over these assets, and over the preparation of federal financial reports.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HIV EMERGENCY RELIEF PROJECT AND FORMULA GRANTS (RYAN WHITE)

Finding Number SA-01-27: Ineffective Monitoring Procedures (Prior Report Finding Number SA-00-30)(First Reported 1999):

The Municipality's internal controls over the monitoring of subrecipients are not designed effectively to monitor activity in order to detect or prevent the payment for services provided to ineligible participants or for ineligible services. From the thirteen (13) service providers of the Program, eleven (11), (85%), were not monitored during the year.

The above situation represents a weakness in the internal control over compliance with the monitoring activities over the service providers. This is because the service providers are responsible for determining eligibility and, since March 1999, the Municipality is not verifying each invoice to determine that the types of services provided as well as the eligibility of these individuals is accurate. Furthermore, since February 1999 the Program's caseworkers became employees of the service providers. Accordingly, the limited review being performed by the Municipality is done only by one person who has no medical or related academic background, which increases the possibility of payments for unallowable services or ineligible participants.

The 45 CFR 92.40(a) establishes that grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function, or activity. We believe that the above condition does not provide adequate assurance that the Municipality's monitoring activities are effective.

Questioned Costs: None.

Recommendation:

The Municipality should hire personnel with academic background and experience in health care to perform periodic monitoring of the activities carried-out by the service providers, and to review and approve medical services invoices.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HIV EMERGENCY RELIEF PROJECT AND FORMULA GRANTS (RYAN WHITE)

Finding Number SA-01-28: Funds Disbursed After Period of Availability:

One out of 25 disbursements selected for testing was not made within the 90 days after the end of the funding period as follows:

Grant Year	Due Date	Number	Check Date	Amount	Payee
March 1, 1999 to February 28, 2000	5/29/2000	2,145	September 12, 2000	\$ 158	Inter Office

The above condition occurred because the Municipality has not taken the appropriate steps to ensure federal fund disbursements are made with the period of availability.

A-102 Common Rule Section 23(b) establishes that all obligations incurred under the award shall be liquidated not later than 90 days after the end of the funding period to coincide with the submission of the annual Financial Status Report – Form SF-269.

The failure to liquidate such obligations within the allowed time period may result in cost disallowances by the federal grantor.

Questioned Cost: None.

Recommendation:

Grant close-out procedures should include the investigation and payment of unliquidated obligations or the return of such funds to the federal grantor.

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

HIV EMERGENCY RELIEF PROJECT AND FORMULA GRANTS (RYAN WHITE)

FINDINGS NOT REPEATED FROM PRIOR AUDIT

- Finding Number SA-00-29: No Documentation Available to Support Compliance with the Suspension and Debarment Requirement – Our audit procedures for the current year did not indicate a lack of compliance.
- Finding Number SA-00-31: Inadequate Cash Management Procedures - Our audit procedures for the current year did not indicate a lack of compliance.

MUNICIPALITY OF PONCE, PUERTO RICO

PART VI

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

MUNICIPALITY OF PONCE, PUERTO RICO

FINDINGS ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO FEDERAL PROGRAMS YEAR ENDED JUNE 30, 2001

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

The following findings and recommendations arise from our follow-up procedures of material instances of noncompliance noted during our Single Audit for the year ended June 30, 2000. These programs were not audited as major programs during our 2001 audit because these did not meet the audit requirements established by OMB Circular A-133.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

PUBLIC SAFETY PARTNERSHIP AND COMMUNITY POLICING GRANTS (COPS)

Finding Number SA-01-29: Noncompliance with Non-Supplanting Requirements:

The Municipality does not have an effective control system over compliance with the non-supplanting requirement established by the COPS Program. We noted that the Municipality had to maintain a level of 370 sworn officers to comply with the federal requirement. This number was calculated using the number of locally-funded officers at time the grant was awarded (290) plus the number of awarded COPS-funded officers (80). The level of employment fluctuated throughout the entire year as follows:

<u>Month</u>	<u>State-Funded</u>	<u>COPS</u>	<u>Total</u>
Jul-00	231	62	293
Aug-00	235	60	295
Sep-00	236	60	296
Oct-00	239	62	301
Nov-00	235	69	304
Dec-00	235	61	296
Jan-01	230	70	300
Feb-01	233	68	301
Mar-01	229	70	299
Apr-01	229	70	299
May-01	223	68	291
Jun-01	223	68	291

This situation is caused due to failure to maintain consistent hiring levels and an inability to fill vacancies as they occur.

Per 42 United States Code Section 3796dd-3(a) states that funds made available to units of local government shall not be used to supplant State or local funds, but shall be used to increase the amount of funds that would, in the absence of Federal fund received under this subchapter, be available from State or local sources. In addition, without including officers hired under COPS grant, all grantees will be expected to proceed with new hiring at a level consistent with historical practice, and to take positive steps to fill all vacancies resulting from the attrition.

The continued failure to meet the minimum employment levels may be considered to be evidence of supplanting and may result in the imposition of sanctions, such as cost disallowances, suspension or termination of participation in the Program.

Questioned Costs: None.

Recommendation:

We recommend the Municipality establish an officer hiring plan consistent to prior year practices that will not only increase the number of sworn officers but also comply with federal regulations.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

PUBLIC ASSISTANCE GRANTS

Finding Number SA-01-30: Lack of Formal Accounting Records to Support Federal Financial Reports:

The Municipality does not maintain a self-balancing set of accounts or any type of formal accounting records to account for the transactions and payments of the Program. The program does not maintain a formal set of books and accounts. Instead, accounting and reporting is supported by spreadsheet-based records. Therefore, the Program does not have current accurate and complete information with regard to the Programs' assets, liabilities, obligations, unobligated balances, nor is there proper accountability and internal control at Program level for the assets owned. In addition, there is no accurate comparison of actual expenditures against budgeted amounts at the account level.

This has occurred because the Municipality has exercised inadequate oversight over the accounting functions of this program by not requiring the establishment of a separate set of books for this fund. Instead, the Municipality has permitted the maintenance of informal accounting records, such as spreadsheets, to support the accountability of a major federal program.

The 45 CFR 92.20(b)(2) establishes that grantees and subgrantees 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 subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. Furthermore, Section 20(b)(3) establishes that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Also, Section 20(b)(4) establishes that actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.

Failure to maintain adequate accounting records may result in transactions not being accounted for, in the recording of unauthorized transactions, the unauthorized use or disposition of program assets or in the preparation of inaccurate or incomplete federal financial reports. Therefore, any amounts not used in accordance with program guidelines, or any unauthorized disposition of assets may result in cost disallowances. Furthermore, failure to compare actual expenditures with approved budget at the account level may result in cost disallowances for exceeding approved budgets.

Questioned Costs: None.

Recommendation:

The Municipality must establish a self-balancing set of accounts for the program and require the accurate and complete maintenance of a full set of accounting records to provide proper accountability over program assets, as well as to enhance the internal controls over these assets, and over the preparation of federal financial reports.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

PUBLIC ASSISTANCE GRANTS

Finding Number SA-01-31: Federal Financial Reports not Submitted to Federal Grantor:

The Municipality did not comply with the requirement of preparing and filing its federal financial reports applicable to the Program. The Municipality only filed a *Project Completion and Certification Report* covering the Program's activities for the year ended June 30, 2001.

However, the Program was required to prepare and submit the following reports:

- SF-270, *Request for Advance and Reimbursement*
- SF-272, *Federal Cash Transactions Report*
- FEMA 20-10, *Financial Status Report (OMB No. 3067-0206)*

The above situation occurred because the Municipality did not ensure to verify and understand its reporting requirements for this Program.

The Municipality is not in compliance with 43 CFR 13.41-(b)(3) which requires federal fund recipients to periodically monitor the performance of grant-supported activities to ensure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved by the preparation of federal financial reports. To achieve these goals, Program management shall prepare accurate and timely federal financial reports.

The continued failure to file the required reports may result in sanctions by the Federal grantor, such as grant payment withholdings.

Questioned Costs: None.

Recommendation:

The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially when new grants are received. This can be achieved by obtaining the information applicable to the Program from the pass-thru grantor, Federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the Federal government.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

LOAN GUARANTEE ASSISTANCE (LGA) (SECTION 108 HUD)

Finding Number SA-01-32: Amounts Due From General Fund:

The Municipality has not reimbursed the federal program for funds transferred in prior years to finance non-federal activities. At June 30, 2001, the amount owed by the Municipality's general fund to the LGA program amounted to \$1,176,001.

This situation occurred because the Municipality incurred expenditures in excess of its available resources in the general fund, and transferred funds from the federal program bank accounts to cover the payments for such expenditures. In addition, the Municipality has not been able to fund this transfer and repay the federal fund.

24 CFR 570.200, establishes the various eligible activities to be financed with these funds. However, none of the sections under this Title allows the transfer of federal funds to finance non-federal related activities.

The continued occurrence of this condition results in the financing of the general fund activities with federal funds and limits the funds available to perform the activities approved under the federal grant. This exposes the Municipality to cost disallowances for the amounts owed and may also result in the assessment of penalties and interest costs on amounts owed to the federal programs.

Questioned Costs: None since this amount has been included as a questioned cost in previous years Single Audit reports.

Recommendation:

The general fund must reimburse the federal program the amount owed as soon as possible. In addition, the Municipality should not permit transfers of federal funds to finance activities not approved by the federal grantor and that are not in accordance with the grant agreements.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

LOAN GUARANTEE ASSISTANCE (LGA) (SECTION 108 HUD)

Finding Number SA-01-33: Noncompliance with Pledge Requirement:

The Municipality does not have an effective internal control system over compliance with the pledge requirements of the LGA Program. During our follow-up procedures we noted that the Municipality did not submit the required pledge document to the federal grantor as guarantee for the repayment of the LGA notes for the 1997-98 grant. The Municipality failed to pledge grants approved or grants for which it may become eligible under 24 CFR 570.705. This must be done in order to assure the repayment of debt obligations and other charges incurred such as issuance, underwriting, servicing, and other costs as a condition for receiving loan guarantee assistance.

This situation occurred because the Municipality does not have effective internal controls to oversee the preparation and submission of the pledge document, as required by LGA regulations, prior to obtaining and using program funds.

Per 24 CFR 570.705, the Municipality shall pledge all grants made or for which it may become eligible to ensure the repayment of debt obligations and the charges incurred such as issuance, underwriting, servicing and other cost, and as a condition for receiving loan guarantee assistance.

In addition, section 4(b) of the Contract for Loan Guarantee Assistance between the Municipality and the Secretary of Housing and Urban Development, dated February 1, 1995 requires that the Municipality should submit to the Secretary an opinion from the Municipality's counsel including the pledge of funds pursuant to 24 CFR 570.705.

The above situation may impair the Municipality's eligibility to obtain future LGA funds, thus exposing the Municipality to diminished federal financial assistance.

Questioned Cost: None.

Recommendation:

The Municipality should immediately submit the required pledge document for the 1997-98 grant. In addition, the Municipality should assign the oversight responsibility to an officer responsible for ensuring the preparation of the corresponding pledge documents for submission to the federal grantor before receiving and using the corresponding program grant funds.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

LOAN GUARANTEE ASSISTANCE (LGA) (SECTION 108 HUD)

Finding Number SA-01-34: Failure to Monitor Program-Income Producing Activities:

The Municipality does not have internal controls over monitor compliance relating to the income producing activities that are funded with Program grants. In prior years the Municipality received financing for the acquisition of Paseo Tablado La Guancha and 6 fully developed acres in front of it to be used for parking and other uses. Program income was supposed to be received from lessees of kioskos at La Guancha. Although the Municipality was required to pledge and deposit that program income in a separate identifiable custodial account called the "Loan Repayment Account", we are unable to determine the uses of this rent income, and no income was pledged and deposited for loan repayment purposes.

This situation has occurred because the Municipality has not established internal controls over compliance with the monitoring of the program-income producing activities to ensure that rent collections are deposited in a separate account to be used for the repayment of the loan. Also, the Municipality has failed to establish internal controls over financial reporting to ensure that these activities are properly accounted for and recorded in the Municipality's accounting records, as required by federal regulation.

The 24 CFR 570, and 504 and 24 CFR Part 85, Sections 85.20 (b)(1)(2) and 85.21 (f), require that the grantee must establish the necessary controls for identifying income-producing activities, recording and using program income in accordance with applicable grant agreements and regulations. This is also required in the LGA loan agreement between the Municipality and HUD.

The continued failure to use program income to pay the LGA loan may allow for funds to be used in ineligible activities to pass undetected, thus exposing the Municipality to cost disallowances for the amounts transferred as well as for program income collected and not used in eligible activities. In addition, the failure to use program income to repay the corresponding loan places an additional limitation in future funding from CDBG, which is the fund that is usually used to repay this loan, because the program income should result in the reduction of the debt service requirement for the corresponding loan.

Questioned Costs: None.

Recommendation:

The Municipality should establish the necessary procedures and ensure that such funds are being deposited in a separate bank account. Furthermore, the Finance Director should be responsible for ensuring that these funds are only to be used for the repayment of the related LGA loan.

MUNICIPALITY OF PONCE, PUERTO RICO

PROGRAMS AUDITED AS MAJOR IN PRIOR YEARS

FINDINGS NOT REPEATED FROM PRIOR AUDIT

- Finding Number SA-00-15 – Public Safety Partnership and Community Policing Grants (COPS) – Bank Reconciliations Not Properly Signed by Finance Director and Subdirector - Our follow-up audit procedures did not indicate a lack of compliance.
- Finding Number SA-00-17 – Job Training Partnership Act (JTPA) – Ineffective Cash Management Procedures – Program was closed during the year.
- Finding Number SA-00-22 – Public Assistance Grants – Bank Reconciliations Not Properly Signed by Finance Director and Subdirector - Our follow-up audit procedures did not indicate a lack of compliance.

MUNICIPALITY OF PONCE, PUERTO RICO

PART VII

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

MUNICIPALITY OF PONCE, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED JUNE 30, 2001

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Grantor's Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE - PASS THROUGH COMMONWEALTH OF PUERTO RICO DEPARTMENT OF EDUCATION - Child and Adult Care Food Program	10.558	CCC-049	<u>\$ 629,677</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT DIRECT PROGRAMS: Community Development Block Grant (CDBG)- Entitlement:			
CDBG 00	14.218		8,332,578
CDBG 99	14.218		177,338
CDBG 98	14.218		141,516
CDBG 97	14.218		47,550
HUD Disaster Recovery Initiative	14.218		1,999,705
Loan Guarantee Assistance	14.218		111,732
Emergency Shelter	14.231		317,560
Home Ownership Partnership Investment	14.239		1,079,682
Section 8 - Tenant-Based Cluster:			
Section 8 Rental Voucher Program	14.855		4,979,165
Section 8 Rental Certificate Program	14.857		176,096
Section 8 - Project-Based Cluster:			
Lower Income Housing Assistance Program - Section 8 - Moderate Rehabilitation I	14.856		761,711
Lower Income Housing Assistance Program - Section 8 - Moderate Rehabilitation II	14.856		<u>431,391</u>
Total U.S. Department of Housing and Urban Development			<u>18,556,024</u>
U.S. DEPARTMENT OF JUSTICE DIRECT PROGRAM - Community Oriented Policing Services	16.710		<u>1,183,838</u>
U.S. DEPARTMENT OF LABOR - PASS THROUGH COMMONWEALTH OF PUERTO RICO DEPARTMENT OF LABOR (EMPLOYMENT AND TRAINING ADMINISTRATION):			
Welfare to Work	17.253	Not Available	1,299,281
Workforce Investment Act	17.255	Not Available	<u>8,258,113</u>
Total U.S. Department of Labor			<u>9,557,394</u>
FEDERAL EMERGENCY MANAGEMENT AGENCY - PASS THROUGH COMMONWEALTH OF PUERTO RICO GOVERNOR AUTHORIZED REPRESENTATIVE OFFICE - Public Assistance Grants	83.544	Not Available	<u>1,083,139</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES DIRECT PROGRAMS:			
Administration for Children, Youth and Families - Head Start	93.600		9,596,490
HIV Cluster: HIV Emergency Relief Project and Formula Grants	93.914		<u>2,372,256</u>
Total U.S. Department of Health and Human Services			<u>11,968,746</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 42,978,818</u></u>

See notes to Schedule of Expenditures of Federal Awards.

MUNICIPALITY OF PONCE, PUERTO RICO

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED JUNE 30, 2001

- A. **Basis of Presentation** - The accompanying schedule of expenditures of federal awards is presented on the modified accrual basis of accounting and was prepared primarily from the Municipality's internal accounting records. The financial statements of the Municipality are presented on the basis of funds and account groups, each of which is considered a separate accounting entity. The operation of each fund is presented in a separate set of self-balancing accounts that comprises its assets, liabilities, fund equity, revenues and expenditures or expenses, as appropriate. Government resources are allocated to and accounted for by individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The accounts and other accounting records of the Municipality were not designed to capture the information required to prepare the general purpose financial statements, consequently, such information was obtained from different individuals, departments and accounting records or reports which are not integrated into a double entry bookkeeping system. In addition, several departments within the Municipality are responsible for managing federal financial assistance and there is no centralized control for all federal financial assistance programs.
- B. **Catalog of Federal Domestic Assistance ("CFDA")** numbers are presented for programs for which such numbers are available.
- C. **Reporting Entity** - The Municipality, for purposes of the supplementary Schedule of Expenditure of Federal Awards, includes all the funds of the primary government as defined by GASB Statement 14, *The Financial Reporting Entity*. It does not include any component units of the Municipality as follows:

Corporación para el Desarrollo Económico de Proyectos Comerciales y de Vivienda de Ponce, C.D.
(CODEPCOVI)
Port of Ponce

CODEPCOVI also received federal financial assistance, but separately satisfied the audit requirements of OMB Circular A-133. The Port of Ponce did not receive federal financial assistance during the year ended June 30, 2001.

D. Subrecipients

Of the federal expenditures presented, the Municipality provided federal awards to subrecipient as follows:

<u>Program Title</u>	<u>Federal CFDA No.</u>	<u>Subrecipients</u>	<u>Amount Provided</u>
Home Ownership Investment Partnership	14.239	CODEPCOVI	\$ 95,250

MUNICIPALITY OF PONCE, PUERTO RICO

PART VIII

**CORRECTIVE ACTION PLANS ON
CURRENT YEAR FINDINGS**



ESTADO LIBRE ASOCIADO DE PUERTO RICO
Gobierno Municipal Autónomo de Ponce
Oficina del Alcalde

Rafael Cordero Santiago
Alcalde

Responses to Findings on Compliance and on Internal Control
over Financial Reporting Based on an Audit of the General Purpose
Financial Statements-Year ended June 30, 2001

Finding 01-01: Operating Deficit of General Fund

In recent years, management has implemented several measures and undertaken certain projects to significantly improve its financial position. As result of these, the accumulated deficit in the General Fund at June 30, 1999 of \$4.9 million (prior to reserves) was eliminated during fiscal year 1999-2000 with a resulting superavit at June 30, 2000 of \$4 million (prior to reserves). This superavit was increased to \$22.3 millions at June 30, 2001 (prior to reserves). However, management is aware that the results of operations are still showing an operating deficiency because expenditures exceed revenues (prior to other financing sources) and accordingly, it has continued with the implementation of several measures and projects to be able to reach the breakeven point. The most important measures and projects implemented are disclosed in Note 18 to the General Purpose Financial Statements and are summarized as follows:

- a) The Municipality, in coordination with the CRIM has implemented two projects oriented to obtaining additional property tax revenues. The first of these projects was started in late 1998 by the CRIM and it relates to a pilot project initially involving certain municipalities (including Ponce) and consisting of intensified collection efforts on the most recent real property tax accounts receivable, the assessment of real property and the revocation of improper homestead exoneration. This pilot project was approved by the CRIM's Board of Directors and was carried on until January 2000 by a joint effort of CRIM's personnel and outside consultants and appraisers. During November 1999, the CRIM informed the Municipality that through October 31, 1999 a total of 1,368 improper homestead exoneration have been identified as part of the pilot project, resulting in an assessment of approximately \$3 million and that a total of 409 real property assessment has been completed, which amount to \$906,000 in additional taxes. The additional property taxes resulting from this project were expected to be collected during fiscal year 2000-2001 and from the most part represent recurring revenues. Even though detailed listings of the real property assessments performed and of the improper homestead exoneration revoked have been provided to the Municipality, the CRIM is yet to provide assurance and evidence that the additional collections from this

pilot project were properly credited to the Municipality as part of the annual comparison of property tax advances vs. actual collections.

The second project was started in 1999 by the Municipality, with the main objective of detecting deficiencies and evasion in the filing of the annual personal property tax returns. As part of the initial phase of this project, the Municipality conducted an economic study and, principally using the municipal license tax roll, determined that for fiscal years 1995-96 through 1997-98, the tax evasion and deficiencies on the self-assessed personal property tax filings amounted to approximately \$21 million for those years. In March 1999, the study was presented to the CRIM's Board of Directors, which granted approval for the Municipality to obtain from the CRIM all the necessary information to carry on the project. On December 8, 1999 the Municipality made a presentation to the Board of Directors of the CRIM to discuss the status of this project. A matching between the CRIM's tax roll of personal property tax filings and the municipal license tax filings has already been made resulting in the identification of specific potential personal property tax evaders. Management has divided the city in eight (8) regions and has commenced to visit the potential evaders to require the filing of the returns for the last four fiscal years. Along with this, collection efforts are being made on the past due real and personal property tax receivables which are currently estimated at \$13.0 million. Through November 2001, a total of approximately \$3.0 million has been collected with regards to this initiative.

These collection are being deposited in a joint bank account agreed to by the Municipality and the CRIM. However, the latter has yet to certify to the Municipality that the amounts deposited in that account have been properly credited to the Municipality as part of the annual comparison of property tax advances vs. actual collections.

The second phase of the project consists of the identification of deficiencies in the personal property tax returns filed and was commenced during fiscal year 1999-2000 and, through November 2001, deficiencies amounting to approximately \$2.5 million have been detected. The Municipality has estimated in approximately \$17 million the deficiencies in the filing of the personal property tax returns during the last four years and errors in the filing of returns of \$2.0 million due to taxpayers not segregating in the tax return the personal property located at Ponce. Also, the Municipality has identified approximately \$4.4 million of property tax collections during fiscal year 1995-96 through 1997-98, not credited to the Municipality as part of the annual settlements of advances vs. collections, for which the CRIM is yet to provide an explanation.

All these claims, estimated deficiencies and collections to date by Municipal personnel were presented to and discussed with the CRIM's new administration, which took over in January 2001. The CRIM's new management ordered a special audit of the annual settlements of property tax advances vs. actual collections for the last five (5) fiscal years and stated that most of the Municipality's claims will be investigated as part of that audit, which is currently in progress and has been going on for approximately nine (9) months. Management believes

that the special audit will result in substantial collections not credited to the Municipality which would reduce or eliminate the outstanding debt to CRIM as result of the aforementioned settlements in recent years. Also, that on a prospective basis, the correction of the problems to be identified through the special audit, should mean additional property tax revenues to the Municipality.

The property tax revenues during fiscal year 2000-01 showed an increase of approximately \$1.4 million, as compared to the prior year, before considering the potential additional revenues discussed above. Also, the preliminary comparison of property tax advances vs. actual collections for fiscal year 2000-01, showed a collection in excess of advances and charges by CRIM, of approximately \$1.3 million.

- b) In order to increase its financing capabilities with the Government Development Bank for Puerto Rico (the "Bank"), on January 16, 1997 and through Ordinance 99, the Municipality increased from 1.25% to 1.50% the ad-valorem portion of the property tax rates which is restricted for debt service. This increase became effective during the fiscal year 1997-98 and increased such rates to 6.53% and 8.53% for personal and real property, respectively. Due in part to the effect of these rate increases, in April 1999 a loan for \$17.7 million and in June 2001 a loan of \$31.7 million, were obtained from the Government Development Bank. The first of these loans was substantially used to pay accounts payable to suppliers recorded in the general fund as of June 30, 1998. The second loan will be used for capital projects. These loans are being paid through the ad-valorem tax restricted for debt service and therefore, will not require the use of operating funds.

Management estimates that due to the recurring effect of the above mentioned increase of the ad-valorem tax and the anticipated increase in such tax as result fo the additional property tax revenues to be generated by the projects described above, the Municipality will be able to obtain loans from the Bank during the near future should there be any significant debt to suppliers in arrears in the general fund as a result of operating deficiencies. The ability of the Municipality to increase its borrowing capacity with the bank in a short period of time, was proved by the fact that as of June 30, 2000 it was about \$8 million and one year later (June 2001), the Municipality was able to obtain a loan of \$31.7 million.

- c) The revenues to be recognized in future years related to the royalties and rent from the administrator of the Municipal landfill will be maintained in the required escrow account and will not be budgeted or expended as part of the general fund regular activities. Such funds will be kept in the escrow account for its intended purpose unless amounts may eventually exceed the closure and post closure estimated costs, in which case such excess may be used to pay any outstanding debt with the landfill administrator or for any other purpose.
- d) Based in part on the opinion of the Municipality's legal counsel, management expects to obtain additional revenues should the outcome of on-going litigation with the Central Government be successful. Such litigation included matters such as deficiencies in the payments of the annual in-lieu of taxes and the overbillings from the Puerto Rico Electric Power Authority (PREPA), payments due from several agencies related to the delegation of

certain powers and duties to the Municipality, and damages awarded to the Municipality in connection with the Central Government discontinuing the construction of about 54 projects included in the Municipal Land Use Plan. When collected, these revenues will represent an additional financial source, which will mitigate the negative effect of any operating deficiency.

The aforementioned overbillings from PREPA were substantially collected in September 2001. The amount settled and collected from PREPA regarding such overbillings was \$2.8 million.

e) In order to achieve its budget control and cost reduction objective, management has established the following measures, among others:

- Managing the Municipality within its cash and budget constraints, including the weekly review and update of its cash flow projections, actual vs. budget comparisons, and the monitoring of the execution of the property tax related projects described above.

- Establishing an immediate short-term cost reduction and cash generating program that systematically identifies and addresses the largest, most effective opportunities for cost reductions and increase in revenues. In connection with this, the Mayor has issued an executive order establishing specific procedures that must be followed by each Department regarding the acquisition of goods and services, in addition to those required by laws and regulations. Before the final issuance of the purchase orders, a division of the Finance Department passes judgement as to the priority, timing and quantity of items being ordered.

- A detailed review of the payroll paid by the general fund was performed in September 1999, which resulted in the identification of certain officers and staff who work directly in the administration of the several federal programs funded by Federal awards, but which payroll costs, payroll taxes and fringe benefits are being paid by the general fund. Such personnel costs have not been included in the grant requests for some of these programs in recent fiscal years, even though the related payroll costs represent allowable costs under the programs. Therefore, starting with the grant requests made during fiscal year 2000-2001, the payroll costs of this personnel have been included as part of the program costs to be funded by Federal awards, so the general fund can experience a reduction in payroll costs.

- As result of the above-mentioned control measures and strategies, total revenues during fiscal years 2000-01 increase by approximately \$3.2 million, mainly due to increases in property and municipal license taxes. Even though the deficiency of revenues over expenditures remained at the \$14 million level, as in the prior year, a reduction of approximately \$1.6 million was achieved regarding the main expenditure category (general government). However, this decrease was offset by the following factors:

- Public safety expenditures increased by \$430,000 due to certain payroll costs of the police force which prior to this year had been subsidized by grants from the Federal Government. As result of this, the police force was not reduced but instead, the general fund assumed the total payroll cost.
- Public works increased by \$1.2 million mainly due to required infrastructure maintenance and improvements, in addition to those originally budgeted.
- Capital outlays increased by \$3.3 million due to construction projects which started or reached their peak during the year and for which loans from the Government Development Bank had been obtained in prior years, but the related expenditures took place during 2000-01. The fact that there were significant capital projects in process at the beginning of the year is supported by the reserve for capital projects of \$9.8 million shown in the combined balance sheet at June 30, 2000.

Responsibility: Mrs. Camille Rivera (Finance Director)
 Mrs. Lolita Vargas (Budget Director)
 Mr. Carlos Jirau, Esq. (City Manager)

Timetable: Within the next two fiscal years (2001-2002 and 2002-2003).

Finding 01-02: Expenditures Quarterly Reports Not Submitted

During the last two fiscal years, each department has submitted to the Finance Department its quarterly expenditures reports, which have been consolidated into general quarterly reports submitted to the Mayor, the Internal Auditor and the Office of the Commissioner of Municipal Affairs, as required by local statutes. The problem consisted in that each department report was not submitted to the Mayor. To correct this situation, instruction will be given to each department head and a standard form will be provided.

Responsibility: Mrs. Camille Rivera (Finance Director)
 Departments' Heads

Timetable: Last two quarters of fiscal year 2001-2002.

Finding Number 01-03: Estimated of Expenditures not Submitted:

A checklist will be developed and implemented by the Budget Director to ascertain that during the preparation of annual budget all Departments submit their estimates of expenditures. Regarding the budget for fiscal year 2000-2001, estimated of expenditures were submitted by all departments but apparently these have been misplaced and were not available for inspection by the external auditors.

Responsibility: Mrs Lolita Vargas (Budget Director)

Timetable: Budget for fiscal year 2002-2003and prospectively.

Finding Number 01-04 Lack of Supporting Documentation for Budgeted Revenue Account:

Prospectively, the Budget Director will ascertain that all revenues budgeted are properly supported, including documentation as to actual amounts realized in prior years, historical trends and economic predictions, as required by the applicable regulations. However, it should be noted that the Office of the Commissioner of Municipal Affair approved the budget for fiscal year 2000-2001, as submitted, and that regarding the two revenue accounts mentioned in this finding, the amounts were estimated primarily based on the anticipated successful outcome of several pending claims made by the Municipality to the CRIM and other government agencies.

Responsibility: Mrs Lolita Vargas (Budget Director)

Timetable: Budget for fiscal year 2002-2003 and prospectively.

Finding 01-05: Inadequate Accounting Practices and Policies

As part of the internal control measures discussed in Note 18 to the general purpose financial statements, the Municipality continues implementing procedures to improve the computerized accounting system, including establishing interface with subsidiary records, integration of the activity of the Federal funds, doble entry accounting for all transactions and issuance of a complete General Ledger. Since January 2000, management has been able to produce interim financial information in accordance with generally accepted accounting principles for the General Fund. This information has helped management to analyze results of operations and prepare cash flow projections and consequently, to better manage its operational budget. Therefore, the continuing development of its accounting system is allowing the Finance Department to implement the appropriate corrective actions to resolve this situation and comply with the applicable Article 8.010 of the Municipal Autonomous Law and with the auditor's recommendations.

In addition, the Mayor has appointed an executive committee to perform an assessment of the financial accounting and reporting needs to undertake the necessary steps to meet the financial reporting requirements of GASB 34, by the end of fiscal year 2001-2002.

Responsibility: Mrs. Camille Rivera (Finance Director)
Mrs. Lolita Vargas (Budget Director)
Mr. Carlos Jirau (City Manager)

Timetable: Fiscal year 2001-2002.

Finding 01-06: Inadequate Accounting for Interfund Transactions

As mentioned in the response to the previous finding, the Municipality is enhancing its computerized accounting system and as part of this, a subsidiary ledger will be established to properly account for interfund transactions.

However, the practice of transferring Federal funds to finance operations of the General Fund, has been discontinued in recent years, following an executive order by the Mayor. The debt by the General Fund to the Head Start Program was fully repaid as of the end of fiscal year 1998-99 and payments continue to be made to LGA. Regarding the debt to the other Programs, transactions have been verified in detail to determine if they actually represent funds due to the Programs and not intra-fund transaction or accounting errors carried over from prior years. The Grantor agencies have been informed about the results of such verification and the Municipality is waiting for their final approval which may result in the elimination of interfund balances due recorded in the General Fund.

Responsibility: Mrs. Camille Rivera (Finance Director)

Timetable: Fiscal year 2001-2002 or shortly thereafter.

Finding 01-07 Inactive and Unnecessary Fund and Account are not Closed:

The Department of Finance has recently completed the analysis of these accounts and the determination of the status of the related projects or grants. As result of this, five (5) of these accounts were closed during December 2000 and any remaining balances transferred to the Operating Account of Municipality. For the other two (2) accounts, it was considered appropriate to maintain these opened as there are still business activities going on regarding the related programs.

Responsibility: Mrs. Camille Rivera (Finance Director)

Timetable: Fiscal year 2001-2002

Finding 01-08: Checks outstanding in Excess of Six Months

Checks will be investigated and will be cancelled. As part of the monthly bank reconciliations procedures, instructions will be given to cancel all checks outstanding over six months.

Responsibility: Mrs. Camille Rivera (Finance Director)
Mrs. Irma Rosado (Finance Deputy-Director)

Timetable: On-going.

Finding 01-09: Bank Reconciliations are not prepared on a timely basis

Significant improvements has been achieved by the Municipality in this area in recent years, as result of a close monitoring by the Finance Director and the implementation of a checklist which includes all bank accounts. The target is to prepare all reconciliations within 30 days after the bank statements are received, which usually happens 15 days after month end. Therefore, bank reconciliations are usually prepared with 45 days after month end.

The few exceptions noted by the auditors will be investigated to find out the specific reasons for the delays and take the measures to prevent these in the future.

Responsibility: Mrs. Camille Rivera (Finance Director)
Mrs. Irma Rosado (Finance Deputy Director)

Timetable: On going.

Finding 01-10: Untimely Contract of the External Auditors

The main reason for this situation was that the bidding process required by local statutes took longer than originally anticipated.

As required by Chapter X of the “Reglamento Revisado sobre Normas Básicas para los Municipios de Puerto Rico”, the Municipality placed an advertisement in a local newspaper requesting quotations for the 2000-01 Single Audit. Procedures similar to a formal bidding process were followed and an evaluation of the proposals submitted was performed by the financial consultants of the Municipality.

After the evaluation was completed and discussed with management, the selection of the accounting firm was made and the negotiation of a contract with this took several weeks. Eventhough the same firm was hired, the process resulted in a significant decrease in the audit fees. For the 2001-02 Single Audit, the auditors selection process will be started earlier to prevent this type of finding.

Responsibility: Mr. Carlos Jirau (City Manager)
Mrs. Camille Rivera (Finance Director)

Timetable: Not later than March 31, 2002.

Finding 01-11: Purchase Order Prepared After Service was Received

During fiscal year 1997-98 the Mayor issued an Executive Order instructing the Department Heads to obtain approval from the Mayor before sending a purchase requisition to the Budget Department, and to ascertain that they have received an approved purchase order before they authorize the supplier to provide the goods or services. The implementation of this order has contributed to prevent the type of situation mentioned in this finding, however, exceptions occur from time to time due to services or goods needed on an emergency basis or to services which are recurring (received every month). Controls will be reinforced regarding compliance with the Executive Order.

Responsibility: Department Heads
Mrs. Camille Rivera (Finance Director)
Mrs. Lolita Vargas (Budget Director)

Timetable: Continuously

Finding 01-12: Inadequate Controls and Accounting Practices over Fixed Assets Subsidiary Ledger

In recent fiscal years controls over fixed assets are being enhanced to allow for having accurate and substantially complete property records. Each Department and Federal Program have a person responsible for the personal property activity (acquisitions, transfers, disposals, etc.), who has to periodically inform the Property Division for actualization of the property records. Standard forms are being used to provide the required information (additions, disposals, transfers, etc.) to the Property Division. Currently, a computerized subsidiary is maintained by this Division, including substantially all of the personal property acquired with both local funds and Federal funds. Also, annual physical inventories are being performed.

Regarding the real property, a subsidiary is being created by the Legal Department as this requires, among other things, the verification of deeds and of the required registration in the Central Government Property Register.

As part of the improvements to the computerized accounting system, the fixed assets subsidiaries will be integrated into the General Ledger to allow the Municipality's general purpose financial statements to reflect all the activity being accounted for in such subsidiaries. This is one of the main goals of the executive committee appointed by the Mayor, which is currently working toward the implementation of the measures necessary to comply with GASB-34 by the end of fiscal year 2001-02.

Responsibility: Mrs. Camille Rivera (Finance Director)
Mrs. Myriam Arroyo (Personal Property Division)
Mrs. Patricia Castaign, Esq. (Legal Department)

Timetable: Fiscal year 2001-2002

Finding 01-13: Lack of Property Physical Inventory:

Exceptions noted by the auditors are being investigated.

In relation to the discrepancies between physical inventories and the subsidiary, during May 2000 a memo was issued by the Property Division to each department which physical inventory showed discrepancies, to assist in the reconciliation of these.

Responsibility: Mrs. Myriam Arroyo (Personal Property Division)
Department Heads, Mrs. Camille Rivera (Finance Director)

Timetable: Ongoing



ESTADO LIBRE ASOCIADO DE PUERTO RICO
Gobierno Municipal Autónomo de Ponce
Oficina del Alcalde

Rafael Cordero Santiago
Alcalde

Management's Corrective Action Plan
on Findings on Compliance and on Internal Control Over Compliance
with Requirements Applicable to Federal Programs
Fiscal Year ended June 30, 2001

Finding SA-01-01: Lack of Reconciliation Procedures

Currently, the Municipality's Finance Department performs all cash disbursements functions of the Programs. The Municipality has assigned personnel to reconcile the Programs' bank accounts and send copies to the various Programs on a timely basis, to ensure recording in the Programs' books of all cash transactions. Also, some of the programs have assigned personnel to assist the Municipality in the reconciliation and cash disbursement procedures. With these measures the Municipality is verifying that transactions recorded at the Municipality's accounting department are also recorded in the Programs' accounting records.

In addition, as part of the enhancement being made to the computerized accounting system, the accounting information maintained at the Programs will be integrated into that system's General Ledger in the corresponding fund. This will allow for a closer monitoring of the transactions related to the Federal Programs and for a centralized accounting system which include all fund types. This is one of the main goals of the executive committee appointed by the Mayor to implement the measures needed to comply with GASB-34.

Responsibility: City Manager, Finance Director and Programs' accountants

Timetable: Fiscal years 2001-2002 and 2002-2003.

Finding Number SA-01-02: Amounts Due from General Fund:

Upon further review of these amounts and assistance received from our financial consultants, we have determined that most likely, the \$392,113 relates to intrafund balance among the various programs under the Municipality's Department of Economic and Community Development (DEC, in it Spanish acronym), and not to amounts withdrawn by the General Fund from DEC. During recent years, several expenditures have been shared by different programs under DEC, whereby one program paid in full for other programs, thus creating intrafund balances. Such balances were apparently not properly accounted for when the Special Revenue fund was consolidated, for purpose of the presentation of the Municipality's General Purpose Financial Statements. This caused the external

auditors to propose, and the Municipality recorded, an adjustment attributing the intrafund balance to General Fund, as if Federal had been transferred to this. Further analysis is need to corroborate this situation and be able to identify the specific intrafund balances that amount to \$392,113 and properly adjust this balance as part of the next year-end closing.

Regarding the remaining \$724,188, the amount resulted from an audit adjustment recorded in fiscal year 1992-93 because of an incorrect debit balance in the deferred revenue account. Management initially determined that this amount resulted from funds transferred to General Fund and recorded in the Program's books a receivable from such Fund. However, a further analysis of the activities for grant years 1985 through 1994 indicated that there were no expenditures in excess of the line of credits, except for 1989 and 1993, which excess amount to only \$76,303, combined. Therefore, we believe that the unidentified amount of \$647,885 (\$724,199 less \$76,303) relates to accounting errors and we are waiting for its final determination to proceed accordingly.

Responsibility: Mr. Miguel Mercado, PE (Program Director)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: Will depend on when the Grantor agency reach a final determination.

Finding SA-01-03: Unsupported Difference in Bank Reconciliation

The financial consultants of the Municipality are currently assisting the Program in investigating and resolving this difference.

Responsibility: Mrs. Myrna Vales (Program Deputy Director)
Mr. Osvaldo Maldonado (Contador IV)

Timetable: Fiscal year 2001-2002.

Finding SA-01-04: Financial Summary Report is Inaccurate

Difference is being investigated and has already been partially adjusted by \$19,600.

Responsibility: Mr. Osvaldo Maldonado (Contador IV)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: Fiscal year 2001-2002.

Finding SA-01-05: Inadequate Cash Management Procedures

The corrective actions described in our response to Finding SA-01-01, have significantly improved the Program's cash forecasting procedures and minimized the occurrence of events of non-compliance regarding the applicable cash management requirements. Such actions include assigning a

staff of the Program to assist the Finance Department of the Municipality to accelerate the disbursement process and monitor the requests of funds which are not made until the Municipality has completed the required approval procedures of the disbursements and is ready to issue the checks. Most of the exceptions noted by the auditors relate to disbursements made one additional day to the three-day requirement.

Responsibility: Mr. Osvaldo Maldonado (Contador IV)
Mr. José Pérez (Finance Director)

Timetable: Continuously.

Finding SA-01-06: Unliquidated Obligations of Closed Program Years not credited to Federal Program

Amounts will be investigated and liquidated. It should be noted that the Program has improved in this area as shown by the fact that in relation to the 1999-2000 audit, there were unliquidated obligations for nine (9) different grant years, while in fiscal year 2000-01, there were only unliquidated funds for two grant years identified by the auditors.

Responsibility: Mr. Osvaldo Maldonado (Contador IV)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: Fiscal year 2001-2002.

Finding SA-01-07: Failure to Monitor Program-Income Producing Activities

During the first semester of fiscal year 2001-02, an evaluation of the program income activities was performed by the financial consultants. The results of this will be discussed with management to determine the course of action required to comply with Federal regulations.

Responsibility: Mrs. Camille Rivera (Finance Director)
Mr. Carlos Jirau, Esq (City Manager)

Timetable: Fiscal year 2001-2002

Finding SA-01-08: Inadequate Property Management Procedures

To properly correct this situation, instructions will be given to reconcile the annual physical inventories already taken with the total shown in the accounting records. In addition, the use and location of the equipment will be verified to ascertain that it is being used for program-related purposes.

Responsibility: Mrs. Myrna Vales (Program Deputy Director)
Property Division (Municipality)

Timetable: Fiscal year 2001-2002.

Finding Number SA-01-09: Interest Earned Not Remitted to Federal Grantor:

Amount was reimbursed to the Federal Grantor on November 29, 2001 through the payment voucher # 02-25-0156.

Finding SA-01-10: Inadequate Cash Management Procedures

Management believes that the cash management procedures being followed are consistent with the standard operating procedures currently accepted by the Grantor, which consists of receiving the funds at the beginning of each month, based on an equitable portion of the approved annual budget, and expending these throughout the month. To date, the Program has not been notified by the Grantor to discontinue this cash management practice.

Responsibility: Mr. Axel López, Esq. (Program Director)
Mrs. Myrna Vales (Program Deputy Director)
Mrs. Camille Rivera (Finance Director)

Timetable: Fiscal year 2001-02 and continuously.

Finding Number SA-01-11 Amounts Due From General Fund:

As a result of an analysis performed by the Municipality to determine if the \$2,000,190 should really be repaid to the Program, as of June 30, 1998 the Municipality recognized revenues for \$969,878 in the Special Revenue Fund resulting from budgetary savings of appropriations for administrative expenditures of the Section 8 Federal Financial Assistance Program, with a corresponding interfund transfer to general fund. The Municipality believes, based on the HUD Accounting Manual, "Housing Assistance Payments Program Accounting Handbook", and on the opinion of their legal counsel, that these budgetary savings can be used for purposes other than administrative expenses of the Section 8 Federal financial assistance and that the Federal grantor will concur with this position. Therefore, the amount due by the General Fund to the Program was substantially reduced and the analysis will be updated (covering fiscal years 1998-99, 1999-2000 and up to date) to determine if more reductions are justified.

Responsibility: Mrs. Camille Rivera (Finance Director)
Mr. Miguel Mercado, PE (Program Director)

Timetable: Fiscal year 2001-2002

Finding SA-01-12: Ineffective Property Management Controls

Refer to response to Finding SA-01-08 as a similar corrective action will be implemented regarding

this finding.

Responsibility: Mr. Alex López, Esq. (Program Director)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: Fiscal year 2001-2002.

Finding SA-01-13: Inadequated Documentation of Participant files

An investigation of each file was performed and substantially all the missing documentation was located or obtained. In some cases, the information was available at the Program, but was not included in the participant's file at the time this was reviewed by the auditor. The information still missing has been requested to the tenant or the landlord, as applicable. An internal memo dated November 2, 2001 was issued to address once again the importance of complying with all the established procedures regarding the management of each case and the documentation of the participants' files. In addition, the Municipality has an internal auditor assigned to perform tests of compliance at several Federal Programs. Such tests include the verification of completeness of the participants' files.

Responsibility: Mrs. Lizette Caballero (Program Supervisor)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: On-going

Finding SA-01-14: Inadequate Cash Management Procedures

Management believes that the cash management procedures being followed are consistent with the standard operating procedures currently accepted by the Grantor, which consists of receiving the funds at the beginning of each month, based on an equitable portion of the approved annual budget, and expending these throughout the month. To date, the Program has not been notified by the Grantor to discontinue this cash management practice.

Responsibility: Mr. Alex López, Esq. (Program Director)
Mr. José Pérez (Finance Director)

Timetable: Depends on what determination the Grantor makes, and when.

Finding SA-01-15: Inadequate Documentation of Participants' files

Exceptions noted by the auditors are being investigated. Refer to response to Finding SA-01-13 for corrective actions implemented.

Responsibility: Mrs. Lizette Caballero (Program Supervisor)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: On-going

Finding SA-01-16: Inadequated Cash Management Procedures:

To improve cash management procedures, in recent years the Program was delaying the request of Funds to the Grantor until the approved disbursement vouchers have been delivered to the Municipality's Finance Department for the processing of the checks. However, the heavy workload at the Finance Department is causing delays in the approval and check issuance procedures. Accordingly, to keep improving cash management procedures, since October 2000 the Program is waiting until the checks are actually received from the Finance Department, prior to making the funds requests. This should help prevent instances of noncompliance with regards to the time elapsing between the receipts of funds and their disbursements.

Responsibility: Mr. Alex Lopez (Program Director)
Mrs. Mirna Vales (Deputy Director)
Mrs. Camille Rivera (Finance Director)

Timetable: Fiscal year 2001-2002

Finding SA-01-17: Noncompliance with the Period of Availability of Federal Funds:

Exceptions noted by the auditors are being investigated.

Responsibility: Mr. Alex López, Esq. (Program Director)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: Fiscal year 2001-2002.

Finding SA-01-18: Ineffective Controls Over Preparation and submission of Federal Financial Reports:

Even though certain Federal Reports showed discrepancies with the Program's accounting records, as describe in this finding, the information included in such reports was substantially correct and the discrepancies noted mainly relate to transactions considered in the Federal Reports submitted, but not on the Program's accounting records. Subsequently, when the accounting records were updated and reconciled, such transactions were recorded on the books and the discrepancies cleared.

Responsibility: Mr. Alex López, Esq. (Program Director)
Mrs. Myrna Vales (Program Deputy Director)

Timetable: Fiscal year 2001-2002.

Finding Number SA 01-19: Inadequate Cash Management Procedures:

To improve cash management procedures, in recent years the Program was delaying the request of Funds to the Grantor until the approved disbursement vouchers have been delivered to the Municipality's Finance Department for the processing of the checks. However, the heavy workload at the Finance Department is causing delays in the approval and check issuance procedures. Accordingly, to keep improving cash management procedures, since October 2000 the Program is waiting until the checks are actually received from the Finance Department, prior to making the funds requests. This should help prevent instances of noncompliance with regards to the time elapsing between the receipts of funds and their disbursements.

Responsibility: Mr. Ramón Anglada, (Program Director)

Timetable: Fiscal year 2001-2002.

Finding Number SA 01-20: Inadequate Cash Management Procedures:

To improve cash management procedures, in recent years the Program was delaying the request of Funds to the Grantor until the approved disbursement vouchers have been delivered to the Municipality's Finance Department for the processing of the checks. However, the heavy workload at the Finance Department is causing delays in the approval and check issuance procedures. Accordingly, to keep improving cash management procedures, since October 2000 the Program is waiting until the checks are actually received from the Finance Department, prior to making the funds requests. This should help prevent instances of noncompliance with regards to the time elapsing between the receipts of funds and their disbursements.

Responsibility: Mr. Ramón Anglada, (Program Director)

Timetable: Fiscal Year 2001-2002

Finding SA-01-21: Ineffective Controls Over Preparation and Submission of Federal Financial Reports

Even though certain Federal Reports showed discrepancies with the Program's accounting records, as describe in this finding, the information included in such reports was substantially correct and the discrepancies noted mainly relate to transactions considered in the Federal Reports submitted, but not on the Program's accounting records. Subsequently, when the accounting records were updated and reconciled, such transactions were recorded on the books and the discrepancies cleared.

Responsibility: Mrs Maria de los Angeles Torres, (Program Director)
Mr. Wilfredo Rodríguez, (sub-Director)

Timetable: Ongoing

Finding SA 01-22 Failure to Meet Full Enrollment Level

The Program is making significant efforts to resolve this situation and meet the required enrollment level. Improvement has already been achieved as evidenced by the fact in fiscal year 1998-99 the enrollment not met was 300 and in fiscal year 1999-2000 was 159, a reduction of almost 50%. During 2001 the Program plans to open seven (7) new centers which will account for an increase of about 130 more participants. This means that by the end of 2001 the deficiency in the enrollment level will only be about 30 participant.

Responsibility: Mrs Maria de los Angeles Torres, (Program Director)
Mr. Wilfredo Rodríguez, (sub-Director)

Timetable: Ongoing

Finding Number 23: Inadequate Cash Management Procedures:

Currently, the request of funds is being made to Grantor once the Program sends to the Municipality's Finance Department the approved disbursement vouchers to proceed with the check preparation and issuance. Apparently, the approval and check issuance procedures at the Finance Department are taking longer than anticipated due to the workload at this Department, and therefore, the Program has opted to change the procedure and delay the request of funds to the Grantor, until it receives notification from the Finance Department that the checks are ready for issuance to the suppliers or employees. This approach should contribute to resolve this problem.

Responsibility: Mrs. Maria de los A. Torres (Program Director)
Mrs. Damaris Suliveres (Accounting Supervisor)
Mrs. Camille Rivera (Finance Director)

Timetable: Fiscal year 2001-2002

Finding SA-01-24: Failure to Meet the Minimum Required Average Daily Attendance Level

Even though controls exist to deal with this compliance issue, the daily attendance of participants is a recurring problem very difficult to deal with, as it usually relates to family matters and circumstances beyond the control of the Program.

Currently, the social services staff of the Program performs periodic visits to the participants' parents to investigate the causes for absenteeism and provide orientation to minimize this. Also, absence patterns are analyzed to evaluate the reasons for these. These controls will continue to be performed and enhanced until the required attendance levels are met.

Responsibility: Area Managers
Mrs. María de los A. Torres (Program Director)

Timetable: Continuously until the required attendance level is met.

Finding SA-01-25: Noncompliance with the Davis-Bacon Act

Regarding construction projects and renovations, the Program has been following statutory laws and regulations, which state that for any construction project of \$40,000 or less, a formal bid procedure is not required and instead, at least three quotations are obtained and a purchase order is issued to the contractor selected with no formal contract issued. To ensure compliance with the Davis-Bacon Act and following the external auditors' recommendations, contracts will be required for any construction/renovation work in excess of \$2,000, which will include a clause representing that wages at not less than the prevailing rates determined by the Department of Labor, will be paid to the various laborers to be employed by the contractor.

In addition, official lists of such rates will be obtained to be able to compare these to the rates shown in the payroll registers submitted by the contractors with the certifications. These procedures should provide for adequate prevent and detect controls regarding compliance with the Davis-Bacon Act.

Responsibility: Mrs. María de los A. Torres (Program Director)
Mr. Wilfredo Rodríguez (Fiscal Officer)

Timetable: Fiscal year 2001-2002

Finding SA-01-26: Lack of Formal Accounting Records to support Federal Financial Reports

Corrective action is in process. The Program is receiving guidance from the financial consultants as to how to establish a formal set of accounting records for the Program and will provide proper training and supervision to the Program's personnel. Also, the need for additional personnel to be assigned to accounting functions is being evaluated.

Responsibility: Mr. Carlos Jirau, Esq. (City Manager)
Mr. José Pérez (Finance Director)
Mr. Luis Cruz (Program Administrator)

Timetable: Fiscal year 2001-2002.

Finding SA-01-27: Ineffective Monitoring Procedures

During fiscal year 2001-2002, the Municipality assigned to the Program an experienced employee to perform monitoring procedures of subrecipients. A work plan is being followed to monitor at least once a year each subrecipient (service providers).

Responsibility: Mr. Carlos Jirau, Esq. (City Manager)
Mr. Luis Cruz (Program Administrator)

Timetable: Fiscal year 2001-2002.

Finding SA-01-28: Funds Disbursed After Period of Availability:

This situation was due to an involuntary error. Controls will be enhanced to prevent this type of situation in the future.

Responsibility: Mr. Luis Cruz (Program Administrator)

Timetable: Fiscal year 2001-2002.

Finding SA-01-29 Noncompliance with Non-Supplanting Requirements:

Corrective action will be coordinated with the Commissioner of the Municipal Police Force to implement the recommendation by the external auditors and comply with Federal regulations.

Responsibility: Police Commissioner
Mr. Carlos Jirau, Esq. (City Manager)

Timetable: Fiscal year 2001-2002

Finding SA 01-30: Lack of Formal Accounting Records to Support Federal financial Report:

Procedures will be implemented to establish a set of accounting records and allow the recording of transactions related to the program, in accordance with the applicable regulation.

Responsibility: Mr. José Chompré (Program Accountant)
Mrs. Camille Rivera (Finance Director)
Mr. Carlos Jirau, Esq. (City Manager)

Timetable : Fiscal year 2001-2002

Finding SA 01-31 Federal financial Report not Submitted to Federal Grantor

Management will evaluate the reporting requirements imposed by the federal regulations and by the pass-thru grantor (GAR), to determine what corrective action is needed. Currently, the request for advances are being made through a form similar to SF-270, which is accepted by the GAR.

Responsibility: Mr. José Chompré (Program Accountant)
Mrs. Camille Rivera (Finance Director)
Mr. Carlos Jirau, Esq. (City Manager)

Timetable : Fiscal year 2001-2002

Finding Number SA 01-32 Amount Due from General Fund:

Payments amounting to \$540,000 were made by the General Fund during fiscal year 1999-2000. Even though there were not payment during 2000-2001, payments will continue during 2001-2002.

Responsibility: Mrs. Camille Rivera (Finance Director)

Timetable : Fiscal year 2001-2002

Finding Number SA 01-33 Noncompliance with Pledge Requirement:

This matter is being handle by the Municipality's legal counsels.

Responsibility: Legal Division (Patricia Castaing, Esq.)
Mr. Miguel Mercado, PE (Program Director)

Timetable: Fiscal year 2001-2002.

Finding Number SA 01-34:Failure to Monitor Program-Income Producing Activities:

Management believes that the operating cost(maintenance, administration, security, etc.) Usually exceed the revenues. Therefore, subject to the preparation of a detail analysis, Management estimates that this activity does not generate income.

Responsibility: Mr. Miguel Mercado, PE (Program Director)
Mrs. Camille Rivera (Finance Director)

Timetable: Fiscal year 2001-2002.

MUNICIPALITY OF PONCE, PUERTO RICO

Independent Auditors' Report

General Purpose Financial Statements
Year Ended June 30, 2001

MUNICIPALITY OF PONCE, PUERTO RICO

GENERAL PURPOSE FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2001

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INDEPENDENT AUDITORS' REPORT

Honorable Mayor and Members of the Municipal Assembly
Municipality of Ponce
Ponce, Puerto Rico

- 1) We have audited the accompanying general purpose financial statements of the Municipality of Ponce, Puerto Rico, as of June 30, 2001 and for the year then ended, listed in the foregoing table of contents. These general purpose financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on this general purpose financial statements based on our audit. We did not audit the financial statements of the Corporación para el Desarrollo Económico de Proyectos Comerciales y de Vivienda de Ponce, C.D. ("CODEPCOVI") and of the Port of Ponce, which are shown as discretely presented component units. The financial statements of CODEPCOVI were audited by other auditors whose report has been furnished to us. Other auditors were engaged to audit the financial statements of the Port of Ponce and their report, which has been furnished to us, disclaimed an opinion because of the limitation on the scope of their audit described in the fourth paragraph. Our opinion on the general purpose financial statements, insofar as it relates to the amounts included for the discretely presented component units, is based solely on the reports of the other auditors.
- 2) Except as discussed in the following paragraph, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. The financial statements of the Port of Ponce were not audited in accordance with Government Auditing Standards. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.
- 3) The Municipality did not maintain detailed records supporting the value of the fixed assets included in the Municipality's general fixed assets account group. Because of the absence of significant accounting records related to these fixed assets, it was not practicable to extend our auditing procedures to enable us to form an opinion on the Municipality's general fixed assets account group.
- 4) The auditors of Port of Ponce were unable to obtain sufficient evidential matter with respect to the balances carried forward for property, plant and equipment and accumulated depreciation for years prior to July 1, 1987. As a result, they were unable to satisfy themselves concerning the amounts at which Port of Ponce's property, plant and equipment and accumulated depreciation are recorded at June 30, 2001, nor were they able to determine the amount of depreciation expense for the year ended June 30, 2001. Because of the limitation on the scope of their audit, the other auditors disclaimed an opinion on the financial statements of the Port of Ponce.

- 5) In our opinion, based on our audit and the reports of other auditors, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to audit the general fixed assets account group referred to in the third paragraph above and had the other auditors been able to audit the opening balances for property, plant and equipment and accumulated depreciation for the Port of Ponce referred to in the fourth paragraph above, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the Municipality of Ponce as of June 30, 2001, and the results of the operations of its governmental fund types and the cash flows of its discretely presented component units for the year then ended in conformity with accounting principles generally accepted in the United States of America.

- 6) In accordance with Government Auditing Standards, we have also issued our report dated December 21, 2001, on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants, which identified material weaknesses related to the lack of adequate accounting records and systems necessary to prepare financial statements as well as the lack of a system of internal control to ensure compliance with laws and regulations which are material to those financial statements. As discussed in those reports, the Municipality has a deficiency in unreserved fund balance of approximately \$20.2 million after reserves in its general fund as of June 30, 2001, and has had recurring deficiencies of revenues over expenditures before other financing resources and negative cash flows from operations. The report on internal control and compliance is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

December 21, 2001

Stamp No. 1759198
affixed to original.

MUNICIPALITY OF PONCE, PUERTO RICO

COMBINED BALANCE SHEET - ALL FUND TYPES, ACCOUNT GROUPS AND DISCRETELY PRESENTED COMPONENT UNITS
 JUNE 30, 2001

	Governmental Fund Types			Account Groups		Totals (Memorandum Only) Primary Government	Discretely Presented Component Units		Totals (Memorandum Only) Reporting Entity
	General	Special Revenue	Debt Service	General Fixed Assets (Unaudited)	General Long-Term Debt		CODEPCOVI	Port of Ponce	
ASSETS AND OTHER DEBITS									
Assets:									
Cash and cash equivalents	\$ 4,955,530	\$ 2,637,235	\$ -	\$ -	\$ -	\$ 7,592,765	\$ 96,818	\$ 2,865,885	\$ 10,555,468
Cash with fiscal agent			13,251,358			13,251,358			13,251,358
Accounts receivable:									
Municipal license tax	201,390					201,390			201,390
Intergovernmental	231,078	6,542,703				6,773,781			6,773,781
Accounts and loans receivable							255,386	255,714	511,100
Due from other governmental entities	1,334,017		342,298			1,676,315			1,676,315
Due from Primary Government								270,820	270,820
Advances to general and special revenue funds	447,479	3,390,306				3,837,785			3,837,785
Other assets							268,699	106,064	374,763
Restricted assets:									
Cash with fiscal agent	36,626,726					36,626,726			36,626,726
Cash held in escrow account for landfill closure and postclosure care costs	3,400,000					3,400,000			3,400,000
Real estate projects under construction							13,122,724		13,122,724
Fixed assets (net of accumulated depreciation for the discretely presented component units)				134,222,289		134,222,289		9,093,776	143,316,065
Other Debts:									
Amount available in debt service fund					6,918,260	6,918,260			6,918,260
Amount to be provided for:									
Retirement of long term debt					95,974,625	95,974,625			95,974,625
Payment of Loan Guarantee Assistance notes					19,245,000	19,245,000			19,245,000
Payment of amounts advanced from CRIM					50,533,654	50,533,654			50,533,654
Payment of accrued compensated absences					9,598,431	9,598,431			9,598,431
Payment of claims and judgments					2,500,000	2,500,000			2,500,000
Payment of landfill closure and postclosure care costs					11,042,682	11,042,682			11,042,682
TOTAL ASSETS AND OTHER DEBITS	\$ 47,196,220	\$12,570,244	\$13,593,656	\$ 134,222,289	\$ 195,812,652	\$ 403,395,061	\$13,743,627	\$12,592,259	\$429,730,947

See notes to general purpose financial statements.

(Continued)

MUNICIPALITY OF PONCE, PUERTO RICO

**COMBINED BALANCE SHEET - ALL FUND TYPES, ACCOUNT GROUPS AND DISCRETELY PRESENTED COMPONENT UNITS
JUNE 30, 2001**

	Governmental Fund Types			Account Groups		Totals (Memorandum Only) Primary Government	Discretely Presented Component Units		Totals (Memorandum Only) Reporting Entity
	General	Special Revenue	Debt Service	General Fixed Assets (Unaudited)	General Long-Term Debt		CODEPCOVI	Port of Ponce	
LIABILITIES, EQUITY AND OTHER CREDITS									
Liabilities:									
Accounts payable and accrued liabilities	\$ 7,749,634	\$ 5,401,273	\$ -	\$ -	\$ -	\$ 13,150,907	\$ 4,815,678	\$ 437,977	\$ 18,404,562
Notes payable							6,790,580	210,029	7,000,609
Due to component unit	270,820					270,820			270,820
Advances from general and special revenue funds	3,390,306	447,479				3,837,785			3,837,785
Deferred revenues:									
Municipal license tax	13,480,504					13,480,504			13,480,504
Federal government		6,559,083				6,559,083	202,264		6,761,347
General obligations:									
Bonds			4,950,000		80,685,000	85,635,000			85,635,000
Interest on bonds			1,725,396			1,725,396			1,725,396
Government Development Bank Loan					22,207,885	22,207,885			22,207,885
Loan Guarantee Assistance notes					19,245,000	19,245,000			19,245,000
Advances from CRIM					50,533,654	50,533,654			50,533,654
Accrued compensated absences					9,598,431	9,598,431			9,598,431
Liability for claims and judgments					2,500,000	2,500,000			2,500,000
Accrued liability for landfill closure and postclosure care costs					11,042,682	11,042,682			11,042,682
Total liabilities	<u>24,891,264</u>	<u>12,407,835</u>	<u>6,675,396</u>		<u>195,812,652</u>	<u>239,787,147</u>	<u>11,808,522</u>	<u>648,006</u>	<u>252,243,675</u>
Equity and Other Credits:									
Retained earnings							1,935,105	7,964,080	9,899,185
Contributed capital (net of amortization of \$2,054,928)							3,980,173	3,980,173	3,980,173
Investment in general fixed assets				134,222,289		134,222,289			134,222,289
Fund balances:									
Reserved for federal programs		162,409				162,409			162,409
Reserved for debt service			6,918,260			6,918,260			6,918,260
Reserved for advances	447,479	3,390,306				3,837,785			3,837,785
Reserved for landfill closure and postclosure care costs	3,400,000					3,400,000			3,400,000
Reserved for capital projects	38,419,109					38,419,109			38,419,109
Reserved for encumbrances	298,304					298,304			298,304
Unreserved fund balance (deficiency)	(20,259,936)	(3,390,306)				(23,650,242)			(23,650,242)
Total equity and other credits	<u>22,304,956</u>	<u>162,409</u>	<u>6,918,260</u>	<u>134,222,289</u>		<u>163,607,914</u>	<u>1,935,105</u>	<u>11,944,253</u>	<u>177,487,272</u>
TOTAL LIABILITIES, EQUITY AND OTHER CREDITS	<u>\$ 47,196,220</u>	<u>\$12,570,244</u>	<u>\$13,593,656</u>	<u>\$134,222,289</u>	<u>\$195,812,652</u>	<u>\$403,395,061</u>	<u>\$13,743,627</u>	<u>\$12,592,259</u>	<u>\$429,730,947</u>

See notes to general purpose financial statements.

(Concluded)

MUNICIPALITY OF PONCE, PUERTO RICO

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES YEAR ENDED JUNE 30, 2001

	General	Special Revenue	Debt Service	Totals (Memorandum Only)
REVENUES:				
Property taxes	\$ 30,525,867	\$ -	\$8,723,327	\$ 39,249,194
Municipal license tax	17,207,104			17,207,104
Royalties and other	1,836,061			1,836,061
Licenses, permits and other local taxes	2,303,993			2,303,993
Charges for services	26,306			26,306
Fines and forfeitures	26,815			26,815
Interest	1,144,927		435,661	1,580,588
Intergovernmental:				
Federal		42,903,341		42,903,341
Local	7,479,839			7,479,839
Rent	228,615			228,615
Other	1,183,293			1,183,293
Total revenues	<u>61,962,820</u>	<u>42,903,341</u>	<u>9,158,988</u>	<u>114,025,149</u>
EXPENDITURES:				
Current:				
General government	23,850,734			23,850,734
Public safety	6,405,239	1,183,838		7,589,077
Public works	14,355,530			14,355,530
Culture and recreation	6,710,750			6,710,750
Health and welfare	10,687,796	22,347,190		33,034,986
Urban development		5,798,916		5,798,916
Legal services	750,619			750,619
Education		9,557,394		9,557,394
Capital outlays	8,057,043			8,057,043
Debt service:				
Principal	3,677,423	2,500,000	4,950,000	11,127,423
Interest	1,846,544	1,496,230	3,608,643	6,951,417
Total expenditures	<u>76,341,678</u>	<u>42,883,568</u>	<u>8,558,643</u>	<u>127,783,889</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>(14,378,858)</u>	<u>19,773</u>	<u>600,345</u>	<u>(13,758,740)</u>
OTHER FINANCING SOURCES (USES):				
Transfers to component unit	(315,000)	(95,250)		(410,250)
Operating transfers from (to) other funds	470,858		(470,858)	-
Proceeds from Municipal Finance Agency	714,993			714,993
Proceeds from issuance of long-term debt	31,765,000			31,765,000
Total other financing sources (uses)	<u>32,635,851</u>	<u>(95,250)</u>	<u>(470,858)</u>	<u>32,069,743</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	<u>18,256,993</u>	<u>(75,477)</u>	<u>129,487</u>	<u>18,311,003</u>
FUND BALANCES, at beginning of year	<u>4,047,963</u>	<u>237,886</u>	<u>6,788,773</u>	<u>11,074,622</u>
FUND BALANCES, at end of year	<u>\$ 22,304,956</u>	<u>\$ 162,409</u>	<u>\$6,918,260</u>	<u>\$ 29,385,625</u>

See notes to general purpose financial statements.

MUNICIPALITY OF PONCE, PUERTO RICO

**COMBINED STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (BUDGETARY BASIS) - GENERAL AND DEBT SERVICE FUNDS
YEAR ENDED JUNE 30, 2001**

	General Fund			Debt Service Fund			Totals (Memorandum Only)		
	Budget	Actual	Variance - Favorable (Unfavorable)	Budget	Actual	Variance - Favorable (Unfavorable)	Budget	Actual	Variance - Favorable (Unfavorable)
REVENUES:									
Property taxes	\$27,567,724	\$30,525,867	\$ 2,958,143	\$8,611,518	\$8,723,327	\$ 111,809	\$36,179,242	\$39,249,194	\$ 3,069,952
Municipal license tax	16,500,000	17,207,104	707,104				16,500,000	17,207,104	707,104
Royalties and other	700,000	1,836,061	1,136,061				700,000	1,836,061	1,136,061
Licenses, permits and other local taxes	4,778,000	2,303,993	(2,474,007)				4,778,000	2,303,993	(2,474,007)
Charges for services	5,000	26,306	21,306				5,000	26,306	21,306
Fines and forfeitures	10,000	26,815	16,815				10,000	26,815	16,815
Interest	2,550,000	1,144,927	(1,405,073)		435,661	435,661	2,550,000	1,580,588	(969,412)
Intergovernmental - local	9,606,309	5,498,607	(4,107,702)				9,606,309	5,498,607	(4,107,702)
Rent	350,000	228,615	(121,385)				350,000	228,615	(121,385)
Other	10,121,295	1,183,293	(8,938,002)				10,121,295	1,183,293	(8,938,002)
Total revenues	72,188,328	59,981,588	(12,206,740)	8,611,518	9,158,988	547,470	80,799,846	69,140,576	(11,659,270)
EXPENDITURES:									
Current:									
General government	30,405,028	23,514,753	6,890,275				30,405,028	23,514,753	6,890,275
Public safety	6,039,337	6,411,670	(372,333)				6,039,337	6,411,670	(372,333)
Public works	13,316,893	14,340,248	(1,023,355)				13,316,893	14,340,248	(1,023,355)
Culture and recreation	6,460,028	6,709,191	(249,163)				6,460,028	6,709,191	(249,163)
Health and welfare	10,547,484	10,687,382	(139,898)				10,547,484	10,687,382	(139,898)
Legal services	988,654	806,300	182,354				988,654	806,300	182,354
Debt service:									
Principal	3,677,417	3,780,142	(102,725)	5,045,000	4,950,000	95,000	8,722,417	8,730,142	(7,725)
Interest	753,487	1,743,825	(990,338)	3,566,518	3,608,643	(42,125)	4,320,005	5,352,468	(1,032,463)
Total expenditures	72,188,328	67,993,511	4,194,817	8,611,518	8,558,643	52,875	80,799,846	76,552,154	4,247,692
OTHER FINANCING SOURCES:									
Proceeds from Municipal Finance Agency		714,993	714,993					714,993	714,993
Proceeds from issuance of long-term debt		31,765,000	31,765,000					31,765,000	31,765,000
Total other financing sources		32,479,993	32,479,993					32,479,993	32,479,993
EXCESS OF REVENUES OVER EXPENDITURES AND OTHER FINANCING SOURCES	\$ -	\$24,468,070	\$24,468,070	\$ -	\$ 600,345	\$ 600,345	\$ -	\$25,068,415	\$25,068,415

See notes to general purpose financial statements.

MUNICIPALITY OF PONCE, PUERTO RICO

COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS - DISCRETELY PRESENTED COMPONENT UNITS YEAR ENDED JUNE 30, 2001

	CODEPCOVI	Port of Ponce
OPERATING REVENUES:		
Facilities rental	\$ -	\$ 754,508
Wharfage		410,828
Equipment rental		633,900
Dockage		291,397
Sales of residential units	4,837,602	
Financing income	6,606	
Other	11,804	277,196
	<u>4,856,012</u>	<u>2,367,829</u>
OPERATING EXPENSES:		
Cost of residential units sold	5,216,506	
Operational		1,398,423
General and administrative	192,040	650,406
Depreciation and amortization		855,558
Other	113,745	
	<u>5,522,291</u>	<u>2,904,387</u>
OPERATING LOSS	(666,279)	(536,558)
NON-OPERATING EXPENSES:		
Interest		(17,411)
Loss on assets disposal		(2,651)
		<u>(20,062)</u>
NET LOSS BEFORE OPERATING TRANSFERS	(666,279)	(556,620)
TRANSFER FROM PRIMARY GOVERNMENT	410,250	
NET LOSS	(256,029)	(556,620)
ADD DEPRECIATION ON FIXED ASSETS ACQUIRED THROUGH CAPITAL CONTRIBUTIONS		<u>191,733</u>
CHANGE IN RETAINED EARNINGS	(256,029)	(364,887)
RETAINED EARNINGS, AT BEGINNING OF YEAR	<u>2,191,134</u>	<u>8,328,967</u>
RETAINED EARNINGS, AT END OF YEAR	<u>\$ 1,935,105</u>	<u>\$ 7,964,080</u>

See notes to general purpose financial statements.

MUNICIPALITY OF PONCE, PUERTO RICO

COMBINED STATEMENT OF CASH FLOWS - DISCRETELY PRESENTED COMPONENT UNITS YEAR ENDED JUNE 30, 2001

	CODEPCOV	Port of Ponce
CASH FLOWS FROM OPERATING ACTIVITIES:		
Operating loss	\$ (666,279)	\$ (536,558)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation and amortization		855,558
(Gain) loss on assets disposal	(2,453)	2,651
Changes in operating assets and liabilities:		
Accounts and loans receivable	54,165	79,378
Due from primary government-general fund		147,111
Other assets	(472)	57,836
Accounts payable and accrued liabilities	6,724	28,275
Deferred revenue	<u>(38,375)</u>	<u> </u>
Net cash provided by (used in) operating activities	<u>(646,690)</u>	<u>634,251</u>
CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES:		
Real estate projects under construction, including capitalized interest	136,820	
Capital contributions		(410,533)
Proceeds from notes payable	36,533	
Repayment of notes payable and obligation under capital leases	(13,072)	(101,412)
Interest paid on long-term debt		(17,411)
Proceeds from sale of land	<u>25,486</u>	<u> </u>
Net cash provided by (used in) capital and related financing activities	<u>185,767</u>	<u>(529,356)</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES -		
Transfers from Primary Government	<u>410,250</u>	<u> </u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(50,673)	104,895
CASH AND CASH EQUIVALENTS, AT BEGINNING OF YEAR	<u>147,491</u>	<u>2,760,990</u>
CASH AND CASH EQUIVALENTS, AT END OF YEAR	<u>\$ 96,818</u>	<u>\$ 2,865,885</u>

See notes to general purpose financial statements.

MUNICIPALITY OF PONCE, PUERTO RICO

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2001

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Ponce (the Municipality) was founded in the year 1692. The Municipality's governmental system consists of an executive and legislative body. It is governed by a Mayor and a sixteen-member Municipal Assembly who are elected for four-year terms.

The Municipality provides public safety, public works, culture and recreation, health and welfare, urban development, education, and other miscellaneous services.

A. The Financial Reporting Entity

The accompanying general-purpose financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The Municipality's discretely presented component units follow accounting principles generally accepted in the United States of America as issued by the Governmental Accounting Standards Board (GASB), and the Financial Accounting Standards Board (FASB) as applicable to each component unit based on the nature of their operations. The discretely presented component units elected not to follow the FASB pronouncements issued after November 30, 1989.

B. Component Units

GAAP defines component units as those entities which are legally separate organizations for which the Municipality's Mayor and Municipal Assembly are financially accountable, or other organizations for which the nature and significance of their relationship with the Municipality are such that exclusion would cause the Municipality's general purpose financial statements to be misleading and incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions.

The following discretely presented component units are in the general purpose financial statements because of the nature of the services they provide and the Municipality's ability to impose its will.

Port of Ponce (POP) was formed as a result of an ordinance, dated November 20, 1911, and enacted by the Executive Council of Puerto Rico, which granted the Municipality authority to construct, maintain and operate a pier, on the shore of the Ponce Harbor. The operations of the port facilities are financed principally through charges to users.

Corporación para el Desarrollo Económico de Proyectos Comerciales y de Vivienda de Ponce, C.D. (CODEPCOVI) was incorporated on September 23, 1985, as a public nonprofit corporation to promote the economic development of the City of Ponce, originally under the name of Ponce Economic Development Corporation. CODEPCOVI'S principal activity consists of granting loans to small businesses. CODEPCOVI'S activities are principally financed through contributions from the Municipality using federal assistance and interest charges to borrowers.

Separate financial statements of the individual component units can be obtained from their respective administrative offices.

Administrative offices:

Port of Ponce
Carretera #10 final
Playa de Ponce
Ponce, Puerto Rico 00731

Corporación para el Desarrollo Económico de Proyectos
Comerciales y de Vivienda de Ponce, C.D.
Condominio Ponciana 3-D
Calle Marina #16
Ponce, Puerto Rico 00731

C. Basis of Presentation

The Municipality reports its financial position and results of operations in funds and account groups, each of which is considered an independent fiscal entity, and through discrete presentation of component units. The operations of each fund are accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund balance/equity, revenues and expenditures/expenses. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. Account groups are a reporting device to account for certain assets and liabilities of the governmental funds not recorded directly in those funds. They are not considered funds because they do not report expendable available financial resources and related liabilities. For financial reporting purposes, the Municipality's reporting entity is divided into the primary government and its discretely presented component units. Individual funds of the primary government are classified as governmental funds.

The Municipality has established the following fund types, account groups, and discrete presentation of component units:

1. Governmental Fund Types

Governmental funds are used to account for the general government functions of the Municipality. The following are the Municipality's governmental funds:

General Fund - This is the general operating fund of the Municipality and accounts for all financial transactions, except those required to be accounted for in another fund.

Special Revenue Funds - These funds account for revenue sources that are legally restricted to expenditures for specified purposes.

Debt Service Fund - This fund is used to account for the accumulation of resources for, and the payment of principal and interest on, the Municipality's general long-term debt obligations which are recorded in the general long-term debt account group. Long-term debt and interest due on July 1 of the following fiscal year are accounted for as a fund liability, if resources are available as of June 30 for its payment.

2. Account Groups

The following account groups are used to establish accounting control and accountability for the Municipality's general fixed assets and long-term obligations:

General Fixed Assets Account Group - This account group is established to account for all fixed assets of the Municipality, other than those accounted for by the component units.

General Long-Term Debt Account Group - This group of accounts is established to account for all long-term debt of the Municipality, other than those accounted for by the discretely presented component units.

3. Discretely Presented Component Units

Discrete component units are used to include the financial information of entities that do not qualify to be blended with the funds and account groups of the primary government. These entities are separate, but are financially accountable to the Municipality.

D. Basis of Accounting and Measurement Focus

The basis of accounting determines when transactions and economic events are reflected in financial statements, and measurement focus identifies which transactions and events should be recorded.

The governmental fund types follow the modified accrual basis of accounting and the flow of expendable financial resources (measurement focus). Under the modified accrual basis of accounting, revenues are recognized when they are both measurable and available. Revenues are measurable when they are subject to reasonable estimation, and are available when they are collectible within the current period or soon enough thereafter to pay current liabilities. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the year to which they apply.

The Municipality considers municipal license tax revenues to be available if they are expected to be collected within five months after the end of the fiscal year and property tax revenues if they are expected to be collected within sixty days after the end of the fiscal year.

In applying the modified accrual basis to intergovernmental revenues (grants, subsidies and shared revenues), the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of such revenues. In some cases, moneys must be expended on the specific purpose or project before any amounts will be paid to the Municipality, therefore, revenues are recognized based upon the expenditures recorded. In other cases, moneys are virtually unrestricted as to purpose of expenditure and revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if they meet the criterion of availability.

Revenues from licenses, permits, service charges, fines, penalties and other miscellaneous collections are recorded as revenues when received because they are generally not measurable until actually received. Investment income is recorded as revenue when earned.

Expenditures are recognized when the related liability is incurred. Principal and interest on bonds are recognized when amounts have been deposited with the fiscal agent to satisfy such debt in the debt service fund. Claims and judgments are recognized when the obligations are expected to be liquidated with expendable available financial resources.

The component units' transactions are accounted for under the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recorded when incurred.

E. Cash, Cash Equivalents, and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts and certificates of deposit with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB). The Municipality's policy is to invest any excess cash in certificates of deposit with institutions qualified by the PRTD. Earnings from these funds are recorded in the corresponding fund.

Cash with fiscal agent in the general fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, loan proceeds from GDB for the payment of current liabilities and for capital projects, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service 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.

Cash and cash equivalents of the component units are maintained in their own names in bank accounts separate from those of the primary government.

For the purpose of the combined statement of cash flow, all investments with an original maturity of three months or less are considered to be cash equivalents.

F. Receivables

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 special revenue fund represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

Loans and accounts receivable of the discretely presented component units are mainly composed of low-income housing mortgages, commercial loans, and charges for services, net of estimated allowances for uncollectible amounts.

G. Real Estate Projects Under Construction

Real estate projects under construction represent the cost of acquisition of real estate and other construction costs incurred by CODEPCOVI for the purpose of developing low-income housing projects for sale to qualifying applicants.

H. Fixed Assets

For governmental fund types, general fixed asset acquisitions are recorded as expenditures in the acquiring fund and are capitalized in the general fixed assets account group for those assets where records are available to support costs. General fixed assets are recorded at cost, or at estimated historical cost if actual historical cost is not available. Donated fixed assets are reported at fair value at the time of donation. No depreciation is provided on general fixed assets, and interest cost incurred during construction is not capitalized. General fixed assets do not include infrastructure such as roads, streets and similar assets that are immovable and of value only to the Municipality.

Component units record their own property, plant and equipment. The assets are capitalized using the same basis used for the capitalization of the general fixed assets except that depreciation is computed by the straight-line method based on the estimated useful lives indicated below:

Description	Years
Buildings and others	10 to 50
Equipment	5 to 10

I. Long-Term Debt

The liabilities reported in the general long-term debt account group include the general and special obligation bonds, bank and long-term notes, other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities and third parties, landfill closure and post closure care costs, except for those accounted for in the discretely presented component units column.

J. Reservations of Fund Balance

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

Advances – Represent the reservation of amounts advanced among the funds of the primary government which are not considered to be current available financial resources. At June 30, 2001, the amounts reserved for advances in the general and special revenue funds were \$447,479 and \$3,390,306, respectively.

Landfill Closure and Postclosure Care Costs – Represent the reservation of the amount required to be held and deposited in an escrow account to cover the closure and post closure care costs of the municipal solid waste landfill facilities. At June 30, 2001, the amount reserved for landfill closure and post closure care costs was \$3,400,000.

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. At June 30, 2001, the amount reserved for capital projects was \$38,419,109. (See Note 16).

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. At June 30, 2001, the amount reserved for encumbrances was \$298,304.

Special Revenue Funds – Represents net assets available for specific use under federal grant programs. At June 30, 2001, the amount reserved was \$162,409.

Debt Service Fund – Represents net assets available to finance future debt service payments. At June 30, 2001, the amount reserved was \$6,918,260.

K. Interfund and Intra-Entity Transactions

The Municipality has the following types of transactions among funds and its discretely presented component units:

Operating Transfers - Legally required transfers that are reported when incurred as “Operating transfers-in” by the recipient fund and as “Operating transfers-out” by the disbursing fund.

Intra-Entity Transactions - There are two types of 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. Balances and transfers between the primary government and discretely presented component units (and among those component units) are reported separately as amounts due from/to component units or primary government.

Advances - Represent the amounts advanced among the funds of the primary government which are not considered to be currently available financial resources.

L. Risk Financing

The Municipality and its component units carry 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 (the “CRIM”) for the year ended June 30, 2001 amounted to approximately \$1,728,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$1,449,000 for workers compensation insurance covering all municipal employees. In the past three years, the Municipality has not settled claims that exceed insurance coverage.

M. 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. This liability is presented in the general long-term debt account group because it will not be funded with expendable financial resources.

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 then current rate, if the employee has at least 10 years of service with the Municipality.

N. Reclassifications to Component Units Amounts

Certain reclassifications have been made to the amounts presented in the separately issued component units financial statements to conform to the presentation used in the Municipality’s general purpose financial statements.

O. Use of Estimates

The preparation of 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, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

P. Total Columns (Memorandum Only)

Total columns on the combined financial statements are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis. Data in these columns does not present consolidated financial position, results of operations, or cash flows in conformity with accounting principles generally accepted in the United States of America. Such data is not comparable to a consolidation since interfund eliminations have not been made.

Q. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality or its component units have not yet adopted:

Statement Number		Adoption required in fiscal year
34	Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Government	2001-02
37	Basic Financial Statements-and Management Discussion and Analysis-for State and Local Governments: Omnibus an amendment of GASB Statements No. 21 and 34	2001-02
38	Certain Financial Statement Note Disclosures	2001-02

The impact of these statements on the Municipality's financial statements has not yet been determined.

2. 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 Assembly prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Assembly. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Assembly.

The Municipality prepares its annual budget including the operations of the general and the debt service funds. In addition, an amount corresponding to the current year Special Revenue Funds is included as Revenues and Expenditures in the approved budget. Certain other budgets are prepared on a grant or project basis, including the activities programmed under the Community Development Block Grant (CDBG), however these are not legally enacted.

The Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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 Assembly 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 Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2001 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2001.

B. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing uses for the year ended June 30, 2001 is presented below for the general, and debt service funds:

	General	Debt Service
Excess of revenues over expenditures and other financing sources (uses) - budgetary basis	\$ 24,468,070	\$ 600,345
Entity differences:		
Non-budgeted funds	(6,075,811)	
Non-budgeted transfers	155,858	(470,858)
Timing differences:		
Prior year encumbrances recorded as current year expenditures for GAAP basis	(589,428)	
Current year encumbrances recorded as expenditures for budgetary purposes	<u>298,304</u>	<u> </u>
Excess of revenues over expenditures and other financing sources (uses) - GAAP basis	<u>\$ 18,256,993</u>	<u>\$ 129,487</u>

C. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

3. 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 \$7,633,950 million in the general fund were fully collateralized at June 30, 2001. In the special revenue fund there were deposits with commercial banks of approximately \$3,531,881 million that were fully collateralized.

The deposits at GDB of approximately \$36.7 million that are restricted principally for capital projects in the general fund, and the \$13.2 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The bank balances with commercial banks of the discretely presented component units of approximately \$1.8 million were fully collateralized.

4. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center (CRIM), a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomy Laws 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 collected 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. Total advances from CRIM as of June 30, 2001 presented in the general long-term debt account group amounted to approximately \$50.5 million. (See Note 13).

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2000-2001, but not the final settlement as the six months period after fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality. Regarding the settlement for fiscal year 1999-00 the difference between the preliminary and the final settlement was approximately \$11,000 (a deviation of less than 1%).

Based on the preliminary settlement already received, during the year ended June 30, 2001, the amount collected from taxpayers and charges by CRIM of approximately \$31.3 million, exceeded the advances received by the Municipality for the same period by approximately \$1.3 million. Such amount is presented as due from other governmental entities in the general fund in the combined balance sheet.

In accordance with Public Law 190 enacted on July 30, 1999 the Municipality was entitled to a moratorium on the payment of any debt to CRIM arising from the final settlements of advances vs. actual collections through fiscal year 1998-99. Such moratorium was due to expire on June 30, 2001 after which date the Municipality had the right to request a payment plan for a period of up to five years, in accordance with Public Law 234, enacted on August 12, 1998. However, on January 26, 2000, Public Law 42 was enacted which revoked laws 190 and 234, and which authorized the CRIM to obtain a loan up to \$200 million, and for a term not exceeding 10 years, to allow for the financing of the debt that the Municipalities have with the CRIM arising from final settlements of property tax advances vs. actual collections through fiscal year 1999-2000. The amounts that the Municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Central Government to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of Public Law 238, enacted on August 15, 1999.

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. Revenues related to the basic tax on exempt property have amounted to approximately \$4,751,000 since fiscal year 1991-92 and are included as part of the property tax collections used by the CRIM in the annual settlement of advances vs. actual collections. 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 for fiscal year 2000-01 is 8.53% for real property and 6.53% for personal property of which 1.03% of both tax rates is for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 6.0% and 4.0%, respectively, represents the Municipality's basic property tax rate which is appropriated for general purposes 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. The Commonwealth also contributes an annual tax rate of 0.2% of the property tax collected and such amount is accounted for similar to item (a) above.

5. MUNICIPAL LICENSE TAX

The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives 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 million or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2001, the tax rates were as follows:

- Financial business - 1.50% of gross revenues
- Other organizations - 0.30% for annual sales up to \$500,000, and 0.50% over such volume.

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 taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues. (See Note 11).

6. INTERGOVERNMENTAL RECEIVABLE AND DUE FROM OTHER GOVERNMENTAL ENTITIES

The amount recorded as intergovernmental receivable in the general fund consist principally of the amount due from the Puerto Rico Electric Power Authority. This represents the net amount resulting from the revenues the Municipality is entitled to receive in lieu of payment of taxes, less the amount billed for electricity consumption by the Municipality.

The amount due from other governmental entities of approximately \$342,000 in the debt service fund represents the ad-valorem tax restricted for debt service collected by the CRIM during June 2001, which was transferred to the Governmental Development Bank for Puerto Rico in July 2001.

Intergovernmental receivable in the special revenue funds principally represents expenditures incurred not yet reimbursed by the Federal government. The amounts were determined taking into consideration the specific years of the grant. Following is a detail of the intergovernmental receivable:

Program Description

Community Development Block Grant	\$1,514,775
Workforce Investment Act	1,312,754
Federal Emergency Management Agency - Georges	1,057,755
Hortense Disaster Recovery Initiative Program	851,023
Home Investment Partnership Program	519,946
Ryan White	416,639
Welfare to Work	330,472
Head Start	201,336
Emergency Shelter	192,733
Child and Adult Care Food Program	65,538
Rental Rehabilitation	53,547
Community Oriented Policing Services	26,185
Total	<u>\$6,542,703</u>

7. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general fund consist mainly of collections from the Commonwealth of Puerto Rico and payments in lieu of taxes from certain public corporations, principally the Puerto Rico Electric Power Authority.

Following is a detail of intergovernmental revenues:

Puerto Rico Electric Power Authority	\$ 4,592,055
Revenue from legislative resolutions, principally for capital projects	1,981,231
Reimbursement from the Commonwealth of Puerto Rico of Christmas bonus expenditure	604,137
Other	<u>302,416</u>
Total	<u>\$ 7,479,839</u>

8. INTERFUND AND INTRA-ENTITY BALANCES AND TRANSACTIONS

Interfund Balances

Interfund receivables and payables are summarized as follows:

Receivable Fund	Payable Fund	Amount
Special revenue	General	<u>\$3,390,306</u>
General	Special revenue	<u>\$ 447,479</u>

The amount owed to the special revenue funds by the general fund arose substantially from interfund transfers during prior years from federal financial assistance programs and is subject to negotiations with the federal funding agencies. No such fund transfers have occurred since fiscal year 1994-1995.

Interfund Transfers

The debt service fund transferred to the general fund \$470,858 representing interest earned on deposits held on behalf of the Municipality by the Government Development Bank for Puerto Rico.

9. ACCOUNTS AND LOANS RECEIVABLE

Component Units

The accounts and loans receivable of the discretely presented component units are composed of the following:

POP, net of allowance for doubtful accounts of \$44,658	\$ 255,714
CODEPCOVI, net of allowance for loan losses of \$16,461	<u>255,386</u>
Total	<u>\$ 511,100</u>

The POP accounts receivable arises from rental and other charges resulting from the normal operations of piers and docks. The loans receivable by CODEPCOVI are related to grant awards, and mortgage and commercial loans to qualified participants. These are related to low-income housing assistance projects and to the promotion of local businesses to stimulate the economic development of Ponce.

10. FIXED ASSETS

The following schedule summarizes the changes in the general fixed assets account group for the year ended June 30, 2001:

Primary Government (Unaudited)

	Beginning Balance	Additions	Retirements	Ending Balance
Real property	\$ 112,492,865	\$ 12,643,853	\$ -	\$ 125,136,718
Personal property	<u>9,085,571</u>	<u> </u>	<u> </u>	<u>9,085,571</u>
Total	<u>\$ 121,578,436</u>	<u>\$ 12,643,853</u>	<u>\$ -</u>	<u>\$ 134,222,289</u>

The Municipality does not maintain accurate accounting records to adequately account for its general fixed assets between land, buildings, and equipment, nor for accurate recording of all assets acquired, disposed, or sold.

Component Units

The discretely presented component units fixed assets consist of:

	Port of Ponce (Unaudited)	CODEPCOVI	Total
Land	\$ 1,285,214	\$ -	\$ 1,285,214
Buildings and others	19,117,558	13,366	19,130,924
Equipment	<u>2,934,941</u>	<u>62,673</u>	<u>2,997,614</u>
Total	23,337,713	76,039	23,413,752
Less accumulated depreciation and valuation reserve	<u>14,243,937</u>	<u>76,039</u>	<u>14,319,976</u>
Total	<u>\$ 9,093,776</u>	<u>\$ -</u>	<u>\$ 9,093,776</u>

The independent auditors of the Port of Ponce could not obtain sufficient competent evidential matter with regards to the balances carried forward of property and equipment and accumulated depreciation for years prior to July 1, 1987.

11. DEFERRED REVENUES

Municipal License Tax

The deferred revenues of approximately \$13.5 million in the general fund relates to municipal license tax collected in fiscal year 2000-01 that will be earned in fiscal year 2001-02.

Federal Government

The deferred revenues presented in the special revenue funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant. These were related to the following federal programs:

Program Title	
Lower Income Housing Assistance and Section 8 Housing Voucher	\$1,675,970
Community Development Block Grant	1,624,385
Loan Guarantee Assistance	1,267,470
Workforce Investment Act	571,985
Rental Rehabilitation	376,805
Welfare to Work	322,859
Child and Adult Care Food Program	258,043
Other	<u>461,566</u>
Total	<u>\$6,559,083</u>

12. PROCEEDS FROM MUNICIPAL FINANCE AGENCY

During the year, the Municipality received approximately \$715,000 from the Puerto Rico Municipal Finance Agency as a result of a refinancing of bonds issued during 1992 and 1994. Such proceeds were recorded as other financing sources in the combined statement of revenues, expenditures and changes in fund balances, and have no restrictions.

13. GENERAL LONG-TERM DEBT

Primary Government

Changes in general long-term debt are summarized as follows:

	Beginning Balance	Borrowings or Additions	Payments or Deductions	Ending Balance
Bonds payable	\$ 53,870,000	\$ 31,765,000	\$ 4,950,000	\$ 80,685,000
Government Development Bank loan	25,885,308		3,677,423	22,207,885
Loan Guarantee Assistance notes	21,745,000		2,500,000	19,245,000
Advances from CRIM (Note 4)	50,533,654			50,533,654
Compensated absences	9,183,431	415,000		9,598,431
Claims and judgments (Note 17)	2,500,000			2,500,000
Landfill obligation (Note 19)	<u>11,042,682</u>			<u>11,042,682</u>
Total	<u>\$ 174,760,075</u>	<u>\$ 32,180,000</u>	<u>\$ 11,127,423</u>	<u>\$ 195,812,652</u>

Bonds payable at June 30, 2001 consists of:

	Outstanding Amount
1991 serial bonds due in annual installments of \$420,000 to \$1,415,000, through July 1, 2006; with interest ranging from 3.26% to 6.36%	\$ 5,995,000
1992 serial bonds due in annual installments of \$150,000 to \$390,000, through July 1, 2007; with interest ranging from 4.16% to 6.41%	1,990,000
1992 special obligations due in annual installments of \$440,000 to \$2,010,000, through July 1, 2012; with interest ranging from 5% to 8%	14,915,000
1997 general obligations due in annual installments of \$410,000 to \$1,220,000, through July 1, 2011; with interest ranging from 4.87% to 6.75%	8,835,000
1997 general obligations due in annual installments of \$345,000 to \$695,000, through July 1, 2006; with interest ranging from 6% to 8%	2,990,000
1999 general obligations due in annual installments of \$1,040,000 to \$1,990,000, through July 1, 2008; with interest ranging from 6% to 7.50%	11,340,000
1999 general obligations due in annual installments of \$115,000 to \$320,000, through July 1, 2013; with interest ranging from 4.87% to 6.11%	2,645,000
2000 general obligations due in annual installments of \$165,000 to \$230,000, through July 1, 2004; with interest ranging from 7.29% to 8%	645,000
2001 general obligations due in annual installments of \$435,000 to \$2,755,000, through July 1, 2025; with interest ranging from 6.13% to 8%	<u>31,330,000</u>
Total outstanding bonds	<u>\$ 80,685,000</u>

These bonds are payable from the additional property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes (see Note 4).

During fiscal year 2000-2001, the Municipality issued \$31,765,000 in General Obligation Bonds for the acquisition and improvements of certain capital projects.

Other long-term debt is composed as follows:

- **Government Development Bank (GDB) Loan**

In October 1986, the Municipality obtained an operational loan from the Government Development Bank for Puerto Rico of \$32,000,000 bearing interest at one half percent ($\frac{1}{2}\%$) over the 90 days LIBOR rate. In December 1992, the Municipality obtained a moratorium for the payment of principal and interest of which approximately \$4,321,000 represented interest capitalized as part of the loan principal outstanding at that time, which amounted to \$33,260,000. In accordance with the terms of the last moratorium, payments of principal and interest of \$1,250,000 were due on a semiannual basis, from July 1994 through January 1997. Starting in July 1997 and continuing through the year 2006, the semiannual payments of principal and interest are approximately \$2.8 million.

- **Loan Guarantee Assistance (LGA) Notes**

These notes are payable in annual aggregate principal installments of \$2,500,000, plus interest rates which fluctuates from 8.04% to 8.19%. The notes are guaranteed by the federal government through the Loan Guarantee Assistance Program and will be repaid from future appropriations to the Municipality's Community Development Block Grant for Puerto Rico program special revenue fund.

- **Advances from CRIM**

This amount represents the balance owed to CRIM at June 30, 2001 as described in Note 4, and that will be repaid through a financing to be obtained by the CRIM, as authorized by law and as explained in that Note.

Annual maturity requirements for the bonds payable, GDB loan and Loan Guarantee Assistance (LGA) Notes are as follows:

Year Ending June 30,	Bonds		GDB Loan	
	Principal	Interest	Principal	Interest
2002	\$ 5,360,000	\$ 5,250,814	\$ 3,910,563	\$ 1,699,623
2003	5,785,000	5,610,318	4,159,103	1,381,886
2004	6,260,000	5,202,787	4,424,061	1,043,944
2005	6,530,000	4,759,378	4,706,520	684,460
2006	7,060,000	4,297,180	5,007,638	302,012
Next 5 years	22,535,000	15,453,237		
Thereafter	<u>27,155,000</u>	<u>17,340,522</u>		
Total	<u>\$ 80,685,000</u>	<u>\$ 57,914,236</u>	<u>\$ 22,207,885</u>	<u>\$ 5,111,925</u>

Year Ending June 30,	Loan Guarantee Assistance Notes	
	Principal	Interest
2002	\$ 2,500,000	\$ 1,307,481
2003	2,500,000	1,117,283
2004	2,500,000	926,055
2005	2,505,000	734,135
2006	2,325,000	547,921
Next 5 years	4,150,000	1,440,296
Thereafter	<u>2,765,000</u>	<u>446,989</u>
Total	<u>\$ 19,245,000</u>	<u>\$ 6,520,160</u>

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, 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. Total property assessed value at June 30, 2001 amounted to approximately \$839 million. General long-term debt, except for the bonds payable and the loan guarantee assistance notes, is paid with unrestricted funds.

Component Units

The notes payable by the discretely presented component units are owed by the Port of Ponce (POP) and CODEPCOVI and are composed of the following:

POP

Note payable to the U.S. Army Corps of Engineers related to POP's share of the costs of certain improvements to the Ponce Harbor, due in July 2022, bearing a variable interest rate.

\$210,029

Fixed maturities required to pay principal and interest of POP were as follows:

Year Ending June 30,	Principal	Interest
2002	\$ 4,441	\$ 15,839
2003	4,774	15,506
2004	5,132	15,148
2005	5,517	14,763
2006	5,931	14,349
Thereafter	<u>184,234</u>	<u>138,989</u>
Total	<u>\$210,029</u>	<u>\$214,594</u>

CODEPCOVI

Construction loan bearing interest at 1.5% over the prime rate, collateralized by a mortgage note over land located at Playa de Ponce Ward, due as housing units are sold

\$ 430,565

Construction loan bearing interest at 1.5% over the prime rate, collateralized by the Municipality and a mortgage note over real estate, due as housing units are sold

6,300,021

Loan bearing interest at 7.9% payable in monthly installments of \$430 due in June 2005 secured by motor vehicles

14,994

Note payable bearing interest at 8.75% due on December 2001, secured by mortgage note

45,000

Total

\$6,790,580

Fixed maturities required to pay principal of CODEPCOVI motor vehicles loan were as follows:

Year Ending June 30,	
2002	\$ 3,386
2003	3,663
2004	3,963
2005	<u>3,982</u>
Total	<u>\$ 14,994</u>

14. COMPONENT UNITS

Contributed Capital - Port of Ponce

The change in contributed capital from \$4,171,906 at June 30, 2000 to \$3,980,173 at June 30, 2001, is due to the depreciation on donated improvements that reduce contributed capital by approximately \$192,000 (unaudited) for the year ended June 30, 2001. This depreciation is added back to compute retained earnings, which is allowed under accounting principles generally accepted in the United States of America as applicable to governmental entities.

The improvements capitalized were substantially financed through federal financial assistance provided by the Municipality under the Economic Development Administration program of the US Department of Commerce. As part of the funding agreement, the Municipality and the Port are subject to a first-priority unilateral mortgage for approximately \$897,000. (See Note 17). No liability has been recorded in POP's accounting records since POP management believes they are in compliance with the applicable requirements.

15. PENSION PLAN

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

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

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

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

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

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total employee and employer contributions during the year ended June 30, 2001 amounted to approximately \$2,369,000 and \$2,758,000, respectively. For the two preceding fiscal years, the Municipality contributed approximately \$2,661,000 and \$2,785,000, which represented 100% of required contributions.

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). Employees participating 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. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of 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 employers' 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, 2001, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

16. COMMITMENTS

Primary Government

Operating Leases

The Municipality leases real property, buildings, vehicles and equipment under several operating lease agreements which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenditures recorded in the general fund for the year ended June 30, 2001, amounted to approximately \$895,000. Management believes that the summary of the future minimum rental commitments under noncancelable real property and equipment lease with terms exceeding one year is not significant.

Construction

The Municipality had commitments at June 30, 2001 of approximately \$38.4 million for the construction, improvements, or renovation of several municipal facilities as follows:

Project Description	Amount
Fine Arts Center	\$ 22,987,947
Improvements to City Hall	6,247,939
Improvements to municipal streets	2,810,277
Access and under ground - La Cantera	868,139
Improvements to Bélgica Ward	500,000
Acquisition of equipment - Municipal Police Department	24,001
Other minor construction	<u>4,980,806</u>
Total amount reserved for capital projects	<u>\$ 38,419,109</u>

Component Units

Port of Ponce

The POP is the lessor of certain dock facilities. Future minimum rentals receivable under such leases at June 30, 2001, is as follows:

Year Ending June 30,	
2002	\$ 790,083
2003	754,613
2004	754,613
2005	754,613
2006	<u>754,613</u>
Total	<u>\$3,808,535</u>

17. CONTINGENCIES, LIABILITY FOR CLAIMS AND JUDGMENTS AND OTHER

Contingencies and Claims and Judgments against the Municipality

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions. 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 condition of the Municipality.

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 "*Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of OMB Circular A-133*" for the year ended June 30, 2001, disclosed several material instances of noncompliance with applicable laws and regulations and with internal accounting and administrative controls.

If expenditures are disallowed due to noncompliance with grant programs regulations, the Municipality may be required to reimburse the grantor. Management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors. Management has provided in the general long-term debt account group an estimated liability for the total exposure for claims and judgments arising from lawsuits or federal actions.

Primary Government Litigations and Claims in Favor of the Municipality

- (a) In May 1993, the Municipality filed a claim against the Central Government of the Commonwealth of Puerto Rico to request the specific enforcement of several contracts pursuant to which the Central Government delegated to the Municipality certain powers and duties previously exercised by certain government agencies. As part of the contracts, the Central Government had to transfer certain employees and funds to the Municipality. Even though most of the employees were transferred, the Central Government refused to transfer the funds. As a result of a 1995 Superior Court decision favorable to the Municipality, some of the government agencies involved in the case transferred to the Municipality during 1995, 1996 and 1997, a total of approximately \$7.6 million related to fiscal years 1992-93 through 1997-98. However, no additional funds have been transferred from those agencies and management estimates that through fiscal year 2001-02 all the agencies involved in this lawsuit and those not included in the lawsuit, owe the Municipality approximately \$3.7 million.

The 1995 Superior Court decision was appealed by the Central Government, but in March 1998 the Circuit Court of Appeals upheld the decision. However, the Appeals Court reversed the Superior Court ruling on the legality of the transfer of employees of said agencies to the Municipality. On November 25, 1998, the Central Government filed a petition of Certiorari before the Supreme Court requesting the reversal of the judgment of the Court of Appeals and that the agreements in question be declared null and void. The Municipality, on its part, filed on November 30, 1998 a Petition of Certiorari before the Supreme Court requesting the reversal of that part of the Circuit Court of Appeals judgment, which declared illegal the transfer of employees to the Municipality. The Municipality also filed with the Supreme Court a Motion in Aid of Jurisdiction requesting an order against the Central Government in light of its default under the agreements. All motions are pending before the Supreme Court. Currently, the Municipality is in the process of negotiating an out-of-court settlement agreement as to amount owed.

- (b) On May 21, 1998, the Municipality filed a claim against the Puerto Rico Electric Power Authority (PREPA) regarding underpayments of the amount due in lieu of taxes as required by law with respect to fiscal years 1989-90 through the current fiscal year. The amount claimed through fiscal year 1999-00 approximates \$17 million. The position of PREPA is that they do not have to pay the amounts claimed by the Municipality because during the years 1989-90 through 1998-99 its net revenues have been insufficient to pay amounts claimed. The Municipality is contesting this position because PREPA has given priority to certain payments that do not have that priority under PREPA's enabling act related to the payments in lieu of taxes. The Municipality's management believes, based on legal counsel opinion, that it is highly probable that the Municipality will prevail in this claim and that the amounts claimed from PREPA will be collected.

In addition, on October 23, 2000, the Municipality filed a second civil action against PREPA requesting the Court to grant an order requiring PREPA to recognize a credit to the Municipality for all the amounts billed to and paid by the Municipality to PREPA from 1992 through 1998 as a result of mistakes made by PREPA in its billing of public lighting services provided to the Municipality. Using PREPA's inventory of public lighting property, management has estimated that during those years PREPA overbilled the Municipality for approximately \$6.8 million. However, PREPA credited the Municipality approximately \$400,000, which represents only the amounts billed in excess during one year. PREPA refused to credit amounts overbilled for the other years because it has a "non-written policy" against such a reimbursement or credits.

The credit to the Municipality of approximately \$400,000, was recorded in the general-purpose financial statements of fiscal year 1999-2000 as a credit to the utilities expenditures and as part of the amount due from governmental entities. During September 2001, the remaining claimed amount of \$6.4 million was settled for \$2.8 million and collected from PREPA.

- (c) In June 1996, the Ponce Superior Court of the Puerto Rico Court of First Instance entered judgment in favor of the Municipality against several government agencies and the Central Government. Through this judgment, the Court ordered the defendants to construct about 54 projects, which management estimates cost approximately \$160 million, which were included in the Municipal Land Use Plan, and also ordered the defendants to pay the Municipality damages in the amount of \$16.5 million. The parties involved were notified of the judgment on June 26, 1996 and from that date, the amount of the judgment earns interest at 5% annually. The judgment was appealed by all defendants to the Circuit Court and on December 2, 1997 the Circuit Court of Appeals upheld the judgment entered by the Ponce Superior Court. However, the Court modified the damage award and determined that the precise amount of damages to be granted to the Municipality should be determined once the projects covered by the judgment are finished. The Municipality was denied a reconsideration of this determination and appealed to the Supreme Court in April 1998 with the purpose of reinstating the damage award. In December 2000, the Supreme Court entered a judgment in favor of the Municipality. Since then, management has been negotiating with the Central Government a work schedule for the realization of the project and the collection of the damages. Recently a coordinator was designated to monitor the construction schedule of the project.
- (d) During fiscal year 1999-2000, the Municipality claimed from the Puerto Rico Aqueduct and Sewer Authority (PRASA) approximately \$2.3 million due to costs incurred by the Municipality in repairing road damages caused by PRASA and power services paid by the Municipality related to PRASA's property. Currently, this claim is being negotiated with PRASA.

Component Units

The POP and the Municipality signed a first-priority unilateral mortgage for \$897,000 on the Port's Tourism Terminal Building for a period of fifteen (15) years ending in September 2011. The mortgage shall become due and payable to the US Economic Development Administration should the facilities be used, transferred, or alienated in violation of the financial assistance award.

A former lessee has named POP and the Municipality defendants in a lawsuit claiming \$1,162,000 in monetary damages in an alleged tort case. The claim is in various stages of litigation. Management of POP and its legal counsel believe that there are meritorious defenses against the legal claim. Further, POP's management also believes that in the event of an unfavorable outcome the ultimate liability, if any, in excess of insurance coverage, will not have a material adverse effect on the financial position and results of operations of POP.

18. OPERATING DEFICIENCIES, MANAGEMENT PLANS AND SUBSEQUENT EVENTS

During fiscal year 2000-2001 and in recent years, the Municipality has experienced deficiencies of revenues over expenditures before other financing resources, and negative cash flows from operations. The Municipality has been able to obtain other financing resources through the issuance of long-term debt for operational purposes with the Government Development Bank for Puerto Rico ("GDB"), through advances from the CRIM in excess of the actual property tax collections, which have been subjected to moratoriums on the repayments and, more recently, to a financing for a period not exceeding 10 years through the enactment of a public law (see Note 4). Going forward, should the Municipality continue to have expenditures in excess of revenues before other financing sources, a financial risk will continue to exist regarding the dependability on financing from GDB and advances in excess of actual property tax collections from the CRIM. To correct this situation, reach the operational breakeven point and prevent advances from the CRIM in excess of actual property tax collection, the Municipality has adopted several measures, some of which are described below:

- (a) The Municipality, in coordination with the CRIM has implemented two projects oriented to obtaining additional property tax revenues. The first of these projects was started in late 1998 by the CRIM and it relates to a pilot project initially involving certain municipalities (including Ponce) and consisting of intensified collection efforts on the most recent real property tax accounts receivable, the assessment of real property and the revocation of improper homestead exoneration. This pilot project was approved by the CRIM's Board of Directors and was carried on until January 2000 by a joint effort of CRIM's personnel and outside consultants and appraisers. During November 1999, the CRIM informed the Municipality that through October 31, 1999 a total of 1,368 improper homestead exoneration have been identified as part of the pilot project, resulting in an assessment of approximately \$3 million and that a total of 409 real property assessments has been completed, which amount to \$906,000 in additional taxes. The additional property taxes resulting from this project were expected to have been substantially collected during fiscal year 2000-2001 and from the most part should represent recurring revenues.

Even though detailed listings of the real property assessments performed and of the improper homestead exoneration revoked have been provided to the Municipality, the CRIM is yet to provide assurance and evidence that the additional collections from this pilot project were properly credited to the Municipality as part of the annual comparison of property tax advances vs. actual collections.

The second project was started in 1999 by the Municipality, with the main objective of detecting deficiencies and evasion in the filing of the annual personal property tax returns. As part of the initial phase of this project, the Municipality conducted an economic study and, primarily using the municipal license tax base roll, determined that for fiscal years 1995-96 through 1997-98, the tax evasion and deficiencies on the self-assessed personal property tax filings amounted to approximately \$21 million for those years. In March 1999, the study was presented to the CRIM's Board of Directors, which granted approval for the Municipality to obtain from the CRIM all the necessary information to carry on the project. On December 8, 1999 the Municipality made a presentation to the Board of Directors of the CRIM to discuss the status of this project. A matching between the CRIM's tax roll of personal property tax filings and the municipal license tax filings was made resulting in the identification of specific potential personal property tax evaders. Management has divided the city in eight (8) regions and is visiting the potential evaders to require the filing of the returns for the last four fiscal years. Along with this, collection efforts are being made on the past due personal and real property tax receivables which are currently estimated at \$13.0 million. Through November 2001, approximately \$3 million has been collected as a result of this initiative. These collections are being deposited in a joint bank account agreed to by the Municipality and the CRIM. However, the latter has yet to certify to the Municipality that the amounts deposited in that account have been properly credited to the Municipality as part of the annual comparison of property tax advances vs. actual collections.

The second phase of the project consists of the identification of deficiencies in the personal property tax returns filed and was commenced during fiscal year 1999-2000 and, through November 2001, deficiencies amounting to approximately \$2.5 million have been imposed.

In addition, the Municipality has estimated approximately \$17 million in deficiencies resulting from the filing of the personal property tax returns during the last four years and errors in the filing of returns of approximately \$2.0 million due to taxpayers not segregating in the tax return the personal property located at Ponce. Also, the Municipality has identified approximately \$4.4 million of property tax collections during fiscal year 1995-96 through 1997-98, not credited to the Municipality as part of the annual settlements of advances vs. collections, for which the CRIM has yet to provide an explanation.

All these claims, estimated deficiencies and collections to date by Municipal personnel were presented to and discussed with the CRIM's new administration, which took over in January 2001. The CRIM's new management ordered a special audit of the annual settlement of property tax advances vs. actual collections for the last five(5) fiscal years and stated that most of the Municipality's claims will be investigated as part of that audit, which is currently in progress and has been going on for approximately nine (9) months. Management believes that the special audit will result in substantial collections not credited to the Municipality which would reduce or eliminate the outstanding debt to CRIM due to excess of property tax advances vs. collections in recent years. Also, that on a prospective basis, the correction of the problems to be identified through the special audit should mean additional property tax revenues to the Municipality.

The property tax revenues during fiscal year 2000-01 showed an increase of approximately \$1.4 million, as compared to the prior year, before considering the amounts discussed above still under investigation and clarification by CRIM. Also, the preliminary comparison of property tax advances vs. actual collections for fiscal year 2000-01, showed a collection in excess of advances and charges by CRIM, of approximately \$1.3 million. As stated in the law, CRIM has until December 31, 2001 to issue the final comparison for fiscal year 2000-01.

- (b) In order to increase its financing capabilities with GDB, on January 16, 1997 and through Ordinance 99, the Municipality increased from 1.25% to 1.50% the ad-valorem portion of the property tax rates which is restricted for debt service (see Note 4). This increase became effective during fiscal year 1997-98 and increased such rates to 6.53% and 8.53% for personal and real property, respectively. Due in part to the effect of these rate increases, in April 1999 a loan of \$17.7 million and in June 2001 a loan of \$31.7 million, were obtained from GDB. The first loan was substantially used to pay accounts payable to suppliers recorded in the general fund as of June 30, 1998. The second loan will be used for capital projects. These loans are being repaid through the ad-valorem tax restricted for debt service and therefore, will not require the use of operating funds.

Management estimates that due to the recurring effect of the above mentioned increase of the ad-valorem tax and the anticipated increase in such tax as result of the additional property tax revenues to be generated by the projects described in (a) above, the Municipality will be able to continue increasing its borrowing capacity with GDB and obtain additional loans during the near future, should there be any significant debt to suppliers in arrears in the general fund as result of operating deficiencies. The ability of the Municipality to increase its borrowing capacity with GDB in a short period of time, was proved by the fact that as of June 30, 2000 it was about \$8 million and one year later (June 2001), the Municipality was able to obtain a loan of \$31.7 million.

- (c) The revenues to be recognized in future years related to the royalties and rent from the administrator of the Municipal landfill (see Note 19) will be maintained in the required escrow account and will not be budgeted or expended as part of the general fund regular activities. Such funds will be kept in the escrow account for its intended purpose, except for amounts which exceed the closure and post closure estimated costs, in which case such excesses may be used to pay any outstanding debt with the landfill administrator or for any other purpose.
- (d) Based in part on the opinion of the Municipality's legal counsel, management expects to obtain additional revenues should the outcome of on-going litigation with the Central Government be successful. Such litigation includes matters such as deficiencies in the payments of the annual in-lieu of taxes and the overbillings from the Puerto Rico Electric Power Authority (PREPA), payments due from several agencies related to the delegation of certain powers and duties to the Municipality, and damages awarded to the Municipality in connection with the Central Government discontinuing the construction of about 54 projects included in the Municipal Land Use Plan. When collected, these revenues will represent an additional financial source, which will mitigate the negative effect of any operating deficiency. As stated in note 17, the aforementioned overbillings from PREPA were substantially collected in September 2001,
- (e) In order to achieve its budget control and cost reduction objective, management has established the following measures, among others:
- Managing the Municipality within its cash and budget constraint, including the periodic review and update of its cash flow projections, actual vs. budget comparisons for budget adjustment as needed, and the monitoring of the execution of the property tax related projects described in (a) above.

- Establishing an immediate short-term cost reduction and cash-generating program that systematically identifies and addresses the largest, most effective opportunities for cost reductions and increase in revenues. In connection with this, the Mayor has issued an executive order establishing specific procedures that must be followed by each Department regarding the acquisition of goods and services, in addition to those required by laws and regulations. Before the final issuance of the purchase orders, a division of the Finance Department passes judgment as to the priority, timing and quantity of items being ordered.
- A detailed review of the payroll paid by the general fund was performed in September 1999, which resulted in the identification of certain officers and staff who work directly in the administration of the several federal programs funded by Federal awards, but which payroll costs, payroll taxes and fringe benefits are being paid by the general fund. Such personnel had not been included in the grant requests approved by some of these programs in recent fiscal years even though the related payroll costs represent allowable costs under the programs. Therefore, starting with the grant requests made during fiscal year 2000-2001, the payroll costs of this personnel have been included as part of the program costs to be funded by federal awards, so the general fund can experience a reduction in payroll costs.
- As result of the above-mentioned control measures and strategies, total revenues during fiscal years 2000-01 increase by approximately \$3.2 million, mainly due to increases in property and municipal license taxes. Even though the deficiency of revenues over expenditures remained at the \$14 million level, as in the prior year, a reduction of approximately \$1.6 million was achieved regarding the main expenditure category (general government). However, this decrease was offset by the following factors:
 - Public safety expenditures increased by \$430,000 due to certain payroll costs of the police force which prior to this year had been subsidized by grants from the Federal Government. As result of this, the police force was not reduced but instead the general fund assumed the total payroll cost.
 - Public works increased by \$1.2 million mainly due to required infrastructure maintenance and improvements, in addition to those originally budgeted.
 - Capital outlays increased by \$3.3 million due to construction projects which started or reached their peak during the year and for which loans from GDB had been obtained in prior years but expenditures took place during 2000-01. The fact that there were significant capital projects in process at the beginning of year is supported by the reserve for capital projects of \$9.8 million shown in the combined balance sheet at June 30, 2000.

The success of the foregoing management plans, as listed in items (a) through (e), to achieve excess revenues over expenditures in its general fund cannot be assured, as it is significantly dependent upon events and circumstances which outcome cannot be presently anticipated. However, management is committed to undertake whatever actions may be necessary to prevent operating deficiencies in the future, but without affecting its fiduciary duty with its citizen regarding services and city improvements.

19. CLOSURE AND POSTCLOSURE CARE COSTS AND LANDFILL OBLIGATIONS

The Municipality owns a landfill, which is used by several municipalities including Ponce and administered by BFI Industries, the landfill administrator, an independent private entity, under an agreement with the Municipality. The Municipality is entitled, under the agreement with the administrator, to certain revenues, principally royalties, resulting from the use of the landfill. In addition, a portion of these revenues is to be deposited in an escrow account to fund the accumulated liability to cover estimated closure and post-closure costs of the landfill. For the year ended June 30, 2001, revenues earned under the agreement amounted to \$1,836,061 and are presented in the accompanying Combined Statement of Revenue, Expenditures and Changes in Fund Balances. The amounts deposited in the escrow account as part of the agreement with the landfill administrator are presented in the accompanying Combined Balance Sheet as cash held in escrow account for landfill closure and post closure care cost. At June 30, 2001 the portion of the revenues required to be deposited in the escrow account was \$3.4 million (same as June 30, 2000).

State and federal laws and regulations require the Municipality to place a final cover on the Municipality's landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. In accordance with Statement No. 18 of the "GASB", "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs", the Municipality obtained a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on the last study performed in October 2001, as of June 30, 2001 the Municipality recognized approximately \$11 million as the Municipality's estimated obligation for landfill closure and post closure care costs. The estimated amount of \$11 million is based on what it would cost to perform all closure and post closure care in 2001 and is reported in the general long-term debt account group because it will not be funded with available expendable financial resources at June 30, 2001. At June 30, 2001, the percentage of landfill capacity used to date was approximately 61% and the estimated remaining life was approximately 5.4 years.

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