

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE QUEBRADILLAS**

**AUDITORIA 2002-2003**

**30 DE JUNIO DE 2003**

AREA DE ASESORAMIENTO  
GERENCIAL Y FISCAL  
2004 SEP 27 PM 2:46

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

**BASIC FINANCIAL STATEMENTS AND  
SUPPLEMENTAL SCHEDULE**

With Independent Auditors' Report Thereon  
June 30, 2003

**MUNICIPALITY OF QUEBRADILLAS, PUERTO RICO**  
**Basic Financial Statements and Supplemental Schedule**  
**Ended June 30, 2003**

**TABLE OF CONTENTS**

**FINANCIAL SECTION**

Independent Auditors' Report ..... 1

Required Supplementary Information (Part I):

    Management's Discussion and Analysis..... 3

Basic Financial Statements:

    Governmental-wide Financial Statement:

        Statement of Net Assets..... 17

        Statement of Activities.....19

    Fund Financial Statements:

        Balance Sheet – Governmental Funds..... 20

        Reconciliation of Balance Sheets- Governmental Funds

            To the Statements of Net Assets..... 21

        Statement of Revenues, Expenditures and

            Changes in Funds Balances- Governmental Funds..... 22

        Reconciliation of the Statement of Revenues,

            Expenditures and Changes in Funds Balance

            To the Statement of Activities..... 23

        Notes to Basic Financial Statements..... 24

Required Supplementary Information

    Budgetary Comparison Schedule – General Fund..... 66

Other Supplemental Information:

    Schedule of Expenditure of Federal Award..... 68

    Notes to Schedule of Expenditure of Federal Awards..... 69

**INTERNAL ACCOUNTING CONTROLS AND COMPLIANCE SECTION**

Independent Auditor's Report on Compliance and on Internal Control:

    In accordance with Governmental Auditing Standards..... 70

Independent Auditor's Report on Compliance and on Internal Control

    In accordance with OMB Circular A-133..... 72

    Schedule of Findings and Questioned Cost..... 74

    Schedule of Prior Years Audits Findings and Questioned Cost..... 88

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 AREA DE ASESORAMIENTO  
 GERENCIAL Y FISCAL  
 2004 SEP 27 PM 2:46

**Independent Auditor's Report**

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

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

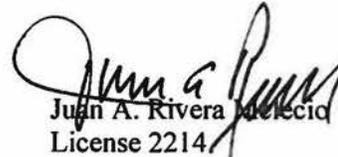
I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Quebradillas of the Commonwealth of Puerto Rico, as of June 30, 2003, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in my opinion, the financial statements refer above present fairly, in all material respects, the budgetary comparison of the general fund for the year ended in conformity with the budgetary (statutory) basic of accounting as describe in note 1.

As described in Note 1, on July 1, 2002 the Municipality implemented a new financial reporting model required by GASB Statement No. 34 (GASB No. 34), *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. In conjunction with the adoption of GASB No. 34, the Municipality has also adopted the following pronouncements: (1) GASB Statement No. 33 - *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 - *Certain Financial Statement Note Disclosures*, and, (4) GASB Interpretation No. 6 - *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

Furthermore, in conjunction with the adoption of GASB No. 34, the Municipality adopted the following pronouncements for its governmental activities reported in the government-wide financial statements: (1) APB Opinion No. 20 – *Accounting Changes*, (2) APB Opinion No. 21 - *Interest on Receivables and Payables*, (3) FASB Statement No. 5 - *Accounting for Contingencies*, and (4) FASB Statement No. 16 – *Prior Period Adjustments*. These pronouncements do not conflict with or contradict any GASB pronouncements adopted by the Municipality.

The accompanying Management's Discussion and Analysis and the Schedule of Funding Progress – Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities are not required parts of the basic financial statements referred to above, but are supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

  
Juan A. Rivera Melecio  
License 2214

Toa Baja, Puerto Rico  
July 12, 2004

Stamp No. 2010565 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



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

Management of the Municipality of Quebradillas of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2003. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

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

**FINANCIAL HIGHLIGHTS**

**a) Government-Wide Highlights**

- **Assets** - The Municipality has reported assets amounting to \$18,054,901 in the accompanying statement of net assets, of which the most significant are capital assets, cash, intergovernmental account receivable and property tax account receivable amounting to \$15,028,394, \$682,832, \$1,602,735 and \$619,419, respectively. These assets account for \$17,933,380 or 99% of the Municipality's total assets.
- **Liabilities** - The Municipality has reported liabilities amounting to \$12,039,070 in the accompanying statement of net assets, of which the most significant are bonds and notes payable, intergovernmental payables, compensated absences, and bank overdraft amounting to \$5,261,756, \$2,163,912, \$967,272 and \$937,347 respectively. These liabilities account for \$9,330,287 or 78% of the Municipality's total liabilities.
- **Net assets** - Municipality assets exceeded its liabilities by \$6,015,831 at June 30, 2003 and are presented as "net assets" in the accompanying statement of net assets. Restricted net assets and unrestricted net liabilities amounted to \$802,407 and (\$5,218,062), respectively. Net assets invested in capital assets amounted to \$10,431,486.
- **Net change in net assets** - The Municipality's net assets decreased by \$714,413 (11% decrease) during fiscal year ended June 30, 2003. Net assets at June 30, 2002 amounted to \$6,015,831. The decrease in net assets represents a negative result of operations in the Municipality's overall financial position in comparison with the prior fiscal year.
- **Revenues** - The Municipality has reported total revenues amounting to \$7,601,255 in the accompanying statement of activities, of which the most significant are tax revenues, capital grants and contributions and grants and contributions (not restricted to specific programs)

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

amounting to \$2,872,532, \$1,291,838 and \$3,887,012, respectively. These revenues account for \$8,051,382 or 84% of the Municipality's total revenues.

- **Expenses** - The Municipality has reported total expenses amounting to \$8,315,668 in the accompanying statement of activities, of which the most significant are categorized as general government, urban and economic development and public safety amounting to \$5,060,595, \$2,420,025 and \$1,030,501, respectively. These expenses accounted for \$8,511,121 or 83% of the Municipality's total expenses.

**b) Governmental Funds Highlights**

- **Assets** - The Municipality's governmental funds have reported combined assets amounting to \$3,516,471 in the accompanying balance sheet – governmental funds, of which the most significant are cash, due from other fund and due from governmental entities amounting to \$682,832, \$973,563 and \$955,912, respectively. These assets account for \$2,612,307 or 74% of the Municipality's combined governmental funds assets.
- **Liabilities** - The Municipality's governmental funds have reported combined liabilities amounting to \$6,208,017 in the accompanying balance sheet – governmental funds, of which the most significant are due to governmental entities, bank overdraft and due to other fund amounting to \$2,163,912, \$937,347 and \$973,561, respectively. These liabilities account for \$4,074,820 or 66% of the Municipality's combined governmental fund liabilities.
- **Governmental fund balances** - The Municipality's governmental funds reported combined fund balances amounting to (\$2,691,546).
- **Net change in governmental fund balances** - The Municipality's governmental fund balances decreased by \$2,031,124 (308% decrease) during fiscal year ended June 30, 2003. Governmental fund balances at June 30, 2002, as restated, amounted to (\$660,422).
- **Revenues** - The Municipality's governmental funds have reported combined revenues amounting to \$8,852,172 in the accompanying statement of revenues, expenditures and changes in fund balances, of which the most significant are tax revenues, intergovernmental grants and contributions and miscellaneous amounting to \$2,604,438, \$5,791,774 and \$439,331, respectively. These revenues account for \$8,835,543 or 99% of the Municipality's combined governmental fund revenues.
- **Expenditures** - The Municipality's governmental funds have reported combined expenditures amounting to \$10,883,296 in the accompanying statement of activities, of which the most significant are categorized as general government, capital outlays, urban and economic development, and public safety amounting to \$4,832,866, \$1,132,067, \$2,225,300 and \$830,366 respectively. These expenses accounted for \$9,020,599 or 83% of the Municipality's total expenses.

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

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

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

The new basic financial statements are the result of a significant change in the focus of financial reporting in comparison with the financial statements previously issued by the Municipality. The new basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds discussed below. Both perspectives (government-wide and major governmental fund financial reporting) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

**a) Government-Wide Financial Statements**

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

**1. Statement of Net Assets**

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

**2. Statement of Activities**

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

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

earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

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

**b) Governmental Fund Financial Statements**

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

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

The governmental fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) major funds, (3) nonmajor funds.

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

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

As previously mentioned, the Municipality has five major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The five major governmental funds are: (1) the general fund, (2) the debt service fund, (3) Join Resolution, (4) SBGP and (5) Land Acquisition.

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

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

**c) Notes to Basic Financial Statements**

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

**d) Required Supplementary Information**

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

**e) Other Supplementary Information**

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

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

**INFRASTRUCTURE ASSETS**

Historically, infrastructure assets, which are one of the Municipality's largest group of assets (consisting of roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. According to GASB No. 34, the Municipality has valued and reported infrastructure assets in the accompanying government-wide financial statements. Additionally, under the provisions of GASB No. 34, the Municipality had the option to either: (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity.

If the Municipality would have developed the asset management system (commonly known as the *modified approach*), then the Municipality would have to measure and demonstrate its maintenance of locally established levels of service standards at least every three years for each infrastructure asset category. Under the modified approach, the Municipality would have recorded its cost of maintenance in lieu of depreciation and amortization. As of July 1, 2002, the Municipality retroactively recorded the estimated historical costs of infrastructure assets in the accompanying government-wide financial statements. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

**GOVERNMENT-WIDE FINANCIAL ANALYSIS**

**a) Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. Total assets and total liabilities at June 30, 2003 amounted to \$18,054,901 and \$12,039,070, respectively, for net assets of \$6,015,831, compared to net assets of \$6,730,244 at June 30, 2002.

The Municipality's net assets include net assets invested in capital assets amounting to \$10,431,486. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. The resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

A portion of the Municipality's net assets amounting to \$802,407 represents resources that are subject to external restrictions on how they may be used. Restrictions on these resources are mainly related to: (1) the future acquisition or construction of capital assets, (2) the future payment of long term debts.

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

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

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

	<b>Governmental Activities</b>
<b><i>Assets:</i></b>	
Current assets	\$ 3,026,507
Noncurrent assets:	
Capital assets, net	15,028,394
Total assets	18,054,091
<b><i>Liabilities:</i></b>	
Current liabilities	5,966,967
Noncurrent liabilities - long-term liabilities due after one year	6,072,103
Total liabilities	12,039,070
<b><i>Net assets (liabilities):</i></b>	
Invested in capital assets, net of related debt	10,431,486
Restricted	802,407
Unrestricted	(5,218,061)
Total net assets	\$ 6,015,831

The Municipality's current assets amounting to \$3,026,507 are mainly composed of restricted cash, intergovernmental and property taxes receivable amounting to \$682,832, \$1,602,735 and \$619,419, respectively. The restricted cash represents resources legally designated for the payment of debt service, the acquisition and construction of major capital assets, and resources designated for the operations of federal and state funded programs. Restricted cash also consist of unused proceeds of bonds issued to pay accounts payable and certain specific commitments, previously agreed with and approved by the Government Development Bank for Puerto Rico.

The Municipality's noncurrent assets amounting to \$15,028,394 are composed of capital assets, net of accumulated depreciation and amortization, amounting to \$4,791,064.

The Municipality's current liabilities amounting to \$5,966,967 are mainly composed of deferred revenues, accounts payable, and the current portions of compensated absences and bank overdraft amounting to \$546,911, \$562,680, \$967,272 and \$937,437, respectively. Deferred revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federal funded programs.

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

The Municipality's noncurrent liabilities amounting to \$6,072,103 are mainly composed of the long-term portions of bonds and notes payable and compensated absences amounting to \$5,261,756 and \$810,347, respectively.

As noted in the condensed statement of net assets, the Municipality's current liabilities exceeded current assets by \$2,940,460, for a current ratio (current liabilities to current assets) of 1.97 to 1.00.

**b) Changes in Net Assets**

The Municipality's net assets decrease by \$714,413 or 11% from last year's total net assets. Approximately 30% of the Municipality's total revenues (\$9,543,043) come from property and municipal license taxes.

The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality were related to: (1) general administration and operating costs (\$5,060,595), which were classified as "general government" and accounted for 49% of total expenses, (2) culture, recreation and education (\$389,755), which accounted for 4% of total expenses, (3) health and sanitation (\$526,056), which accounted for 5% of total expenses, (4) urban and economic development (\$2,420,025), which accounted for 24% of total expenses, and (5) public housing and welfare (\$561,469), which accounted for 5% of total expenses.

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

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

**Commonwealth of Puerto Rico  
Municipality of Quebradillas  
Statement of Net Assets  
June 30, 2003**

<b>Assets</b>		<b>Governmental Activities</b>
<b>Current assets:</b>		
Accounts receivable, net of allowance for doubtful accounts:		
Taxes:		
Property taxes	\$ 619,419	
Municipal license taxes	90,099	
Intergovernmental	1,602,735	
Other	14,054	
Inventories and other current assets		17,368
<b>Restricted assets:</b>		
Cash with commercial banks		114,902
Cash with fiscal agent		567,930
Property taxes, net of allowance for doubtful accounts		
Total current assets		3,026,507
<b>Noncurrent assets:</b>		
Capital assets, net of accumulated depreciation and amortization of \$4,791,064		15,028,394
Total noncurrent assets		15,028,394
Total assets		\$ 18,054,901

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
MANAGEMENT DISCUSSION AND ANALYSIS**

Governmental activities decrease the Municipality's net assets by \$714,413. A comparison of the cost of services by function for the Municipality's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities.

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

*Net expenses:*

General government	\$ (5,060,595)
Urban and economic development	(2,420,025)
Public safety	(1,030,501)
Health and sanitation	( 526,056)
Culture, recreation and education	( 389,755)
Public housing and welfare	( 561,469)
Interest on long-term obligations	( 269,055)
Total governmental activities' net expenses	<u>(10,257,456)</u>

*General revenues:*

Taxes	2,872,532
Unrestricted intergovernmental grants and contributions	3,887,012
Other revenues sources	<u>2,783,499</u>
Total governmental activities general revenues	<u>9,543,043</u>
Net increase in net assets	<u>\$ ( 714,413)</u>

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

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At June 30, 2003, the Municipality's governmental funds reported combined fund balances of (\$2,691,546), a decrease of (\$2,031,124 or 308% in comparison with the prior year. There are \$802,406 of reserved fund balances which indicated that this amount is not available resource for new spending because it has already been committed: (1) to liquidate contracts and purchase orders of the prior fiscal year (\$52,595), (2) to pay debt service (\$131,569), and (3) for capital projects (\$618,242).

The general fund is the main operating fund of the Municipality. At the end of the current fiscal year, unreserved fund deficit of the general fund was \$3,493,952. The fund balance of the general fund decreased by \$732,466 due to an excess of expenses and other financing uses over revenues and other financing sources.

Combined revenues of governmental funds for the year ended June 30, 2003 amounted to \$8,852,172, while total combined revenues for the prior year amounted to \$8,894,311. This represents a decrease of \$42,139 in comparison with the prior year.

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

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

**Condensed Balance Sheet - Governmental funds  
June 30, 2003**

<b>Assets:</b>	
Total assets - major funds	\$ 3,218,376
Total assets - nonmajor funds	298,095
Total assets	<u>3,516,471</u>
<b>Liabilities:</b>	
Total liabilities - major funds	5,964,696
Total liabilities - nonmajor funds	243,321
Total liabilities	<u>6,208,017</u>
<b>Fund Balances:</b>	
Reserved - major funds	738,632
Reserved - nonmajor funds	63,774
Unreserved - major funds	<u>(3,493,952)</u>
Total fund balances (Deficit)	<u>\$ (2,691,546)</u>

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

<b>Revenues:</b>	
Total revenues - major funds	\$ 8,209,032
Total revenues - nonmajor funds	643,140
Total revenues	<u>8,852,172</u>
<b>Expenditures:</b>	
Total expenditures - major funds	10,257,536
Total expenditures - nonmajor	625,760
Total expenditures	<u>10,883,296</u>
<b>Other financing sources (uses), net:</b>	
Major funds	94,660
Nonmajor funds	<u>(94,660)</u>
Total other financing sources (uses), net	<u>                    </u>
<b>Excess of expenditures and other financing uses over revenues and other financing sources</b>	
	(2,031,124)
<b>Fund balance at beginning of year, as restated</b>	<u>(660,422)</u>
<b>Fund balance at end of year (Deficit)</b>	<u>\$ (2,691,546)</u>

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

**BUDGETARY HIGHLIGHTS**

**a) General Fund**

The original budget and the final amended budget of the general fund remained substantially the same except for the reclassification of expenditures made throughout the year. Over the course of the year, the Municipality revised the general fund's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law requires a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2003 were \$5,966,204, which is \$452,239 less than the budgeted revenues.

The total actual expenditures (budgetary basis) of the general fund for the same year previously mentioned were \$6,365,608, which is \$52,835 less than the budgeted expenditures.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**a) Capital Assets**

The accompanying statement of net assets reported total capital assets, at cost, amounting to \$19,819,458, of which \$2,670,333 represents infrastructure assets at June 30, 2003. The related accumulated depreciation and amortization of capital assets amounted to \$4,791,064 of which \$1,573,264 is related to infrastructure assets at June 30, 2003. The investment in capital assets includes land and land improvements, buildings and buildings improvements, machinery and equipment, licensed vehicles, furniture and fixtures, infrastructure and construction in progress.

The net book value of capital assets at June 30, 2003 is distributed by function/activity. Actual expenditures to purchase or construction of capital assets were \$1,140,281 for the year.

The increase in net capital assets at June 30, 2003 in comparison with the respective figures at June 30, 2002 was \$860,422. This increase is due to the net effect of the additions to capital assets amounting to \$1,140,281 made during the year, and the effect of depreciation and amortization expense of \$279,859.

**b) Debt Administration**

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

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

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

**b) Debt Administration (Cont.)**

The laws and regulations of the Commonwealth of Puerto Rico have established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged. The applicable laws and regulations also require that in order for a municipality to be able to issue additional general obligation bonds and notes, it must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in the Municipality's redemption fund and the annual amounts collected with respect to the Municipality's Special Additional Tax, as projected by the Government Development Bank for Puerto Rico, is sufficient to service the maturity of the Municipality's outstanding general obligation debt and the additional proposed general obligation debt (payment capacity).

The Municipality is required under applicable laws and regulations to levy the special additional tax in such amounts as required for the payment of its general obligation municipal bonds and notes. In addition, principal and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's basic tax revenues. Accordingly, the Municipality's basic tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the special additional tax levied by the Municipality, together with moneys on deposit in the Municipality's redemption fund, are not sufficient to cover such debt service. It has never been necessary to apply basic taxes to pay debt service on general obligation debts of the Municipality.

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

**REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report is intended to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Quebradillas, Department of Finance, P.O. 1544, Quebradillas, Puerto Rico, 00678.

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
Statement of Net Assets  
June 30, 2003

	<u><b>Governmental Activities</b></u>
<b>Assets</b>	
<b>Current assets:</b>	
Accounts receivable, net of allowance for doubtful accounts:	
Taxes:	
Property taxes	\$ 619,419
Municipal license taxes	90,099
Intergovernmental	1,602,735
Other	14,054
Inventories and other current assets	17,368
Restricted assets:	
Cash with commercial banks	114,902
Cash with fiscal agent	567,930
Property taxes, net of allowance for doubtful accounts	
Total current assets	<u>3,026,507</u>
<b>Noncurrent assets:</b>	
Capital assets, net of accumulated depreciation and amortization of \$4,791,064	<u>15,028,394</u>
Total noncurrent assets	<u>15,028,394</u>
Total assets	<u><u>\$ 18,054,901</u></u>

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

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
Statement of Net Assets (continued)  
June 30, 2003

**Current liabilities (due within one year):**

Bankoverdraft	\$	937,347
Accounts payable		562,680
Accrued liabilities, including accrued interests of \$108,792		257,430
Intergovernmental payables		2,163,912
Deferred revenues		546,911
Current portion of long-term obligations		
Bonds payable		315,700
Notes payable		35,715
Compensated absences		967,272
Claims and judgments		180,000
Total current liabilities		5,966,967

**Noncurrent liabilities (due in more than one year):**

Bonds payable		4,293,100
Notes payable, including bond anticipation notes		968,656
Compensated absences		810,347
Total noncurrent liabilities		6,072,103
Total liabilities		12,039,070

**Net assets (liabilities):**

Invested in capital assets, net of related debt		10,431,486
Restricted for:		
Capital projects	\$ 618,242	
Debt service	131,569	
Other specified purposes	52,596	
Total restricted net assets	802,407	
Unrestricted net assets		(5,218,062)
Total net assets		6,015,831

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
Statement of Activities  
June 30, 2003

<u>Functions/programs</u>	<u>Expenses</u>	<u>Charges for services</u>	<u>Program Revenues</u>		<u>Net Expenses and Charges in Net Assets</u>
			<u>Operating grants and contributions</u>	<u>Capital grants and contributions</u>	
Governmental activities					
General government	\$ 5,060,595	11,442			\$ (5,049,153)
Urban and economic development	2,420,025		226,151	1,291,838	(902,036)
Public safety	1,030,501				(1,030,501)
Health and sanitation	526,056				(526,056)
Culture, recreation and education	389,755				(389,755)
Public housing and welfare	561,469		412,357		(149,112)
Interest on long-term obligation	269,055				(269,055)
Total governmental activities	<u>\$ 10,257,456</u>	<u>11,442</u>	<u>638,508</u>	<u>1,291,838</u>	<u>(8,315,668)</u>
General Revenues:					
Taxes:					
Property taxes					2,213,326
Municipal license taxes					468,907
Construccion excise taxes					190,299
Total taxes					<u>2,872,532</u>
Grants and contributions, not restricted to specific programs					3,887,012
Unrestricted investments earnings					5,186
Miscellaneous					439,332
Special items - Puerto Rico Electric Power Authority					397,193
Total general revenues and special items					<u>7,601,255</u>
Net changes in net assets					(714,413)
Net assets at beginning of the year					6,730,244
Net assets at the end of the year					<u>\$ 6,015,831</u>

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
**Balance Sheet - Governmental Funds**  
**June 30, 2003**

	Major Funds							Total Governmental Funds
	General Fund	Debt Service Fund	Joint Resolution Fund	Land Acquisition Fund	State Block Grant Fund	Other Governmental Funds		
<b>Assets</b>								
Receivables, net of allowances for uncollectibles accounts:								
Taxes:								
Property taxes	\$ 619,419	-	-	-	-	-	\$ 619,419	
Municipal license taxes	90,099	-	-	-	-	-	90,099	
Intergovernmental	-	-	-	-	140,437	36,903	177,340	
Due from other funds	219,056	-	493,507	125,000	-	136,000	973,563	
Due from governmental entities	793,643	335	161,934	-	-	-	955,912	
Due from federal financial assistance	-	-	-	-	-	3,252	3,252	
Other	14,043	-	-	-	-	11	14,054	
Restricted assets :								
Cash with commercial banks	-	-	-	660	-	110,698	111,358	
Cash with fiscal agent	-	556,699	-	-	3,544	11,231	571,474	
Property taxes receivable, net of allowance for uncollectible accounts	-	-	-	-	-	-	-	
<b>Total assets</b>	<b>1,736,260</b>	<b>557,034</b>	<b>655,441</b>	<b>125,660</b>	<b>143,981</b>	<b>298,095</b>	<b>3,516,471</b>	
<b>Liabilities</b>								
Bank overdraft	925,243	-	12,104	-	-	-	937,347	
Accounts payable	340,554	-	-	-	143,476	5,639	489,669	
Due to other funds	754,507	973	161,934	-	505	55,642	973,561	
Due to governmental entities	2,163,912	-	-	-	-	-	2,163,912	
Deferred revenues	367,427	-	-	-	-	-	367,427	
Deferred intergovernmental revenues	678,569	-	-	-	-	8,036	686,605	
Deferred federal financial assistance	-	-	-	-	-	165,004	165,004	
Matured bonds due and payable	-	424,492	-	-	-	-	424,492	
<b>Total liabilities</b>	<b>5,230,212</b>	<b>425,465</b>	<b>174,038</b>	<b>-</b>	<b>143,981</b>	<b>234,321</b>	<b>6,208,017</b>	
<b>Fund Balances</b>								
Reserved for:								
Debt service	-	131,569	-	-	-	-	131,569	
Capital projects	-	-	481,403	125,660	-	11,179	618,242	
Other specified purposes	-	-	-	-	-	52,595	52,595	
Unreserved, reported in:								
General fund	(3,493,952)	-	-	-	-	-	(3,493,952)	
<b>Total fund balances</b>	<b>(3,493,952)</b>	<b>131,569</b>	<b>481,403</b>	<b>125,660</b>	<b>-</b>	<b>63,774</b>	<b>(2,691,546)</b>	
<b>Total liabilities and fund balances</b>	<b>\$ 1,736,260</b>	<b>557,034</b>	<b>655,441</b>	<b>125,660</b>	<b>143,981</b>	<b>298,095</b>	<b>\$ 3,516,471</b>	

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
**Reconciliation of the Balance Sheets-Governmental Funds**  
**to the Statements of Net Assets**  
**June 30, 2003**

Governmental activities amounts reported in the statements of net assets and the balance sheet-governmental funds are different because:

Aggregate fund balance reported in the balance sheets - governmental funds	\$ (2,691,546)
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Add (Deduct):

Inventories and others current are not available to pay current period expenditures, therefore are not reported in the governmental funds	17,368
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Capital assets used in governmental activities are not financial resources, therefore are not reported in the governmental funds	15,028,394
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Deferred revenues in the governmental funds that are recognized as revenues in the statements of activities	1,138,356
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The following liabilities are not due(mature) in the current period, therefore are not reported in the governmental funds:

Accounts payable and accrued liabilities and interest	(221,651)
Intergovernmental payables	
Bonds and notes payables	(5,297,471)
Compensated absences	(1,777,619)
Claims and judgments	<u>(180,000)</u>

Governmental activities net assets reported in statements of net assets	<u><u>\$ 6,015,831</u></u>
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The accompanying notes to the basic financial statements are an integral part of this statement.

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
**Statement of Revenues, Expenditures and**  
**Changes in Fund Balances - Governmental Funds**  
**Year Ended June 30, 2003**

	<b>Major Funds</b>						<b>Total Governmental Funds</b>
	<b>General Fund</b>	<b>Debt Service Fund</b>	<b>Joint Resolution Fund</b>	<b>Land Acquisition Fund</b>	<b>State Block Grant Fund</b>	<b>Other Governmental Funds</b>	
<b>Revenues:</b>							
<b>Taxes:</b>							
Property taxes (notes 4 and 11)	\$ 1,723,489	221,743					\$ 1,945,232
Municipal license taxes (note 3)	468,907						468,907
Construction excise taxes	190,299						190,299
Charges for services	11,443						11,443
<b>Intergovernmental grants and contributions (note 5):</b>							
Federal government				879,722	412,357		1,292,079
State government	3,861,610		411,934			226,151	4,499,695
Investment earnings (notes 2 and 6)	4,211		275	36	7	657	5,186
Miscellaneous	435,356					3,975	439,331
<b>Total revenues</b>	<b>6,695,315</b>	<b>221,743</b>	<b>412,209</b>	<b>36</b>	<b>879,729</b>	<b>643,140</b>	<b>8,852,172</b>
<b>Expenditures:</b>							
<b>Current:</b>							
General government	4,654,272					178,594	4,832,866
Urban and economic development	807,638		167,918	1,074,376	174,021	1,347	2,225,300
Public safety	827,195					3,171	830,366
Health and sanitation	416,167					63,375	479,542
Culture, recreation and education	218,170					36,851	255,021
Public housing and welfare	228,454					273,077	501,531
<b>Debt service:</b>							
Principal (note 11)	33,634	315,700				-	349,334
Interest (note 11)	43,790	225,265				-	269,055
<b>Capital outlays (note 9):</b>							
Construction and remodeling of public facilities	112,823		244,191		705,708	69,345	1,132,067
Machinery, equipment and vehicles	8,214						8,214
<b>Total expenditures</b>	<b>7,350,357</b>	<b>540,965</b>	<b>412,109</b>	<b>1,074,376</b>	<b>879,729</b>	<b>625,760</b>	<b>10,883,296</b>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<b>(655,042)</b>	<b>(319,222)</b>	<b>100</b>	<b>(1,074,340)</b>	<b>-</b>	<b>17,380</b>	<b>(2,031,124)</b>
<b>Other financing sources (uses):</b>							
Transfers-in from other funds (note 8)	97,701	172,084				3,041	272,826
Transfers-out to other funds (note 8)	(175,125)					(97,701)	(272,826)
<b>Total other financing sources (uses), net</b>	<b>(77,424)</b>	<b>172,084</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(94,660)</b>	<b>-</b>
<b>Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses</b>	<b>(732,466)</b>	<b>(147,138)</b>	<b>100</b>	<b>(1,074,340)</b>	<b>-</b>	<b>(77,280)</b>	<b>(2,031,124)</b>
<b>Fund Balance at beginning of year, as restated (note 14)</b>	<b>(2,761,486)</b>	<b>278,707</b>	<b>481,303</b>	<b>1,200,000</b>		<b>141,054</b>	<b>(660,422)</b>
<b>Fund Balance at end of year</b>	<b>\$ (3,493,952)</b>	<b>131,569</b>	<b>481,403</b>	<b>125,660</b>	<b>-</b>	<b>63,774</b>	<b>\$ (2,691,546)</b>

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

**Commonwealth of Puerto Rico**  
**Municipality of Quebradillas**  
 Reconciliation of Statement of Revenues, Expenditures and Changes  
 in Fund Balance - Governmental Funds to the Statements of Activities  
 June 30, 2003

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

Net change in fund balances reported in statement of revenue, expenditures and change in fund balances - governmental funds	\$ (2,031,124)
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Add(deduct):

The following revenues recorded in the statement of activities do not provide current financial resources, therefore are deferred in the governmental funds:

Property taxes	268,094
Intergovernmental grants and contributions	25,584
Special item PREPA legal case	397,193

Governmental funds report capital outlays as expenditures. However in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expenses. This the amount by which capital outlays exceeded depreciation and amortization expenses	1,140,281
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Repayment of principal og long-term obligation is an expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets	349,334
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Some expenses reported in the statements of activities do not requiere the use of currents financial resources, therefore are not reported as expenditures in the governmental funds	<u>(863,775)</u>
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Net changes in net assets reported in statements of activities	<u><u>\$ (714,413)</u></u>
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The accompanying notes to the basic financial statements are an integral part of this statement.

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

**1. Summary of Significant Accounting Policies**

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

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

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

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

**a) *New Financial Reporting Model***

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

**a) *New Financial Reporting Model (Cont.)***

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**b) *Financial Reporting Entity***

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor, and (2) whose funds are under the legal custody and control of the Municipality's Finance Director, as prescribed by Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico*.

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

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

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

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

**c) *Government-Wide Financial Statements***

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

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

*c) Government-Wide Financial Statements (Cont.)*

on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

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

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

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

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

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

**c) Government-Wide Financial Statements (Cont.)**

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

- **Unrestricted Net Assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

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

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

**General government:**

- Municipal legislature
- Mayor's office
- Department of finance
- Department of human resources
- Department of municipal secretary
- Department of internal audit
- Department of federal programs
- Department of public relations

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

*c) Government-Wide Financial Statements (Cont.)*

**Urban and Economic Development:**

Department of public works

**Public Safety:**

Department of civil defense

**Health and Sanitation**

Department of sanitation

**Culture, Recreation and Education:**

Department of recreation and sports

**Welfare:**

Center for the elderly

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

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

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct, or renovate capital assets associated with a specific program.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS

Notes to Basic Financial Statements

June 30, 2003

c) *Government-Wide Financial Statements (Cont.)*

- **Program-specific capital and operating grants and contributions (Cont.)** -Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

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

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

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

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

The accompanying GWFS do not report fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no significant operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

Accordingly, the accompanying GWFS do not report fiduciary nor business-type activities.

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

**d) *Governmental Fund Financial Statements***

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

Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity or deficit, revenue, and expenditures. The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

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

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

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

**d) Governmental Fund Financial Statements (Cont.)**

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

The use of the capital project funds has been reserved for major capital acquisitions or construction activities that would distort financial resource trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

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

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

***d) Governmental Fund Financial Statements (Cont.)***

governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes means all expenditures, including operating and non-operating expenditures, except for other financing uses.

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

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

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

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

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

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

*e) Measurement Focus and Basis of Accounting (Cont.)*

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

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

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

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

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

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

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

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

*e) Measurement Focus and Basis of Accounting (Cont.)*

**Governmental Fund Financial Statements** - The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2003, except for property taxes for which the availability period is 60 days.

Revenue sources not meeting these availability criteria or collected in advance are recorded as deferred revenues at June 30, 2003. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, and investment earnings. These principal revenue sources meet the measurability and availability criteria in the accompanying GFFS.

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

*e) Measurement Focus and Basis of Accounting (Cont.)*

**Governmental Fund Financial Statements**

Modifications to the accrual basis of accounting include:

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

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

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

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

*f) Stewardship, Compliance and Accountability*

**Budgetary Control**

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

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

*f) Stewardship, Compliance and Accountability (Cont.)*

**Budgetary Control**

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

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

*f) Stewardship, Compliance and Accountability (Cont.)*

**Budgetary Accounting**

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

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

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

*g) Unrestricted and Restricted Deposits*

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

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

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

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

Restricted cash in other governmental funds represents: (1) resources restricted to finance the operations of federal and state funded programs, and (2) resources restricted for the acquisition, construction and improvements of capital improvements.

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

***h) Unrestricted and Restricted Accounts Receivable***

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

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

Intergovernmental receivables are mainly composed of amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to state and federally funded programs (recorded in the special revenue fund).

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

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Advances between funds, as reported in the GFFS, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

***i) Inventories and Other Current Assets***

Inventories and other current assets recorded consist of materials, supplies, food and medicine inventories held for consumption; and prepaid expenses. Generally, inventories are stated at cost using the first-in, first-out method (FIFO) in the GWFS (consumption method). Inventories and prepaid expenses in the GFFS are recorded as expenditures (purchase method) when purchased (paid) rather than capitalized as an asset. Only significant amounts of inventory or prepaid expenses at the end of the year, if any, would be capitalized in the GFFS.

***j) Cash equivalents***

Cash equivalents are composed of certificates of deposit with original maturities of less than three months. Investments are held with commercial banks and are recorded at cost (which approximates fair value).

***k) Deferred Charges***

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

***1) Capital Assets***

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying GWFS. Infrastructure assets are generally immovable in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets. The Municipality has no collection of works of art or historical treasures.

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

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

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

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

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	50
Infrastructure	20 to 50
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20

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

***l) Capital Assets (Cont.)***

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

***m) Deferred Revenues***

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

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

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

***n) Compensated Absences***

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the government-wide statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2003, and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences, include salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of Social Security taxes, Medicare taxes, employer contributions to the employees’ retirement systems and others). The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year). Employees accumulate sick leave at a rate of 1.5 days per month (18 days per year). Compensatory time is accumulated by employees at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 60 days and 90 days, respectively, are paid to employees each year if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

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

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

***n) Compensated Absences (Cont.)***

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

***o) Long-term Debt***

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

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

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

On July 1, 2002, the Municipality adopted the provisions of APB Opinion No. 21, *Interests on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to the Puerto Rico Treasury Department. According to APB No. 21, the Municipality has recorded these notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if had been negotiated by an independent lender. In the accompanying statement of net assets, this note payable is reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the note.

The note discount is amortized over the life of the note using the effective interest method. Amortization of the note discount is recorded as part of interest expense in the statement of activities. In the GFFS, note discounts are recognized as other financing uses during the current period.

***p) Accounting for Pension Costs***

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

***p) Accounting for Pension Costs (Cont.)***

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

***q) Risk Management***

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

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

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

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

***r) Reservations of Fund Balances***

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

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

***s) Interfund Transactions***

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

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

***t) Use of Estimates***

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**2. Deposits and Investments**

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

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

The Municipality's bank balances of deposits with financial institutions are categorized to provide an indication of the level of custodial risk assumed by the Municipality at year-end. Risk categories are described as follows:

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

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

	Major Funds					Total Governmental Funds
	Debt	Land	State	Other	Governmental Funds	
	General Fund	Service Fund	Acquisition Fund	Block Grant Program		
Unrestricted:						
Deposits in commercial banks	-	\$ -	\$ -	\$ -	\$ -	\$ -
Restricted:						
Deposits in commercial banks			660	3,544	110,698	114,902
Deposits in GDB, and fiscal agent		556,699			11,231	567,930
<b>Total carrying amounts of deposits</b>	<b>-</b>	<b>\$556,699</b>	<b>\$660</b>	<b>\$3,544</b>	<b>\$121,929</b>	<b>\$682,832</b>

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

**2. Deposits and Investments (Cont.)**

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

	Major Funds					Total Governmental Funds
	General Fund	Debt Service Fund	Land Acquisition Fund	State Block Grant Program	Other Governmental Funds	
Unrestricted:						
Category 3:						
Deposits in						
commercial banks	-	-	-	-	-	-
Restricted:						
Category 1:						
Deposits in						
commercial banks			\$660	8,801	116,769	\$126,230
Category 3:						
Deposits in GDB, and						
fiscal agent		\$556,699			11,231	567,930
Total carrying						
amounts of deposits	-	\$556,699	\$660	\$8,801	\$128,000	\$694,160

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

**3. Municipal License Taxes**

The Municipality is authorized by law to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Quebradillas. This is a self-assessed tax based on the business volume in gross sales. The Municipality establishes the applicable tax rates. At June 30, 2003, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for any other taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

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

**3. Municipal License Taxes (Cont.)**

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

**4. Property Taxes**

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

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force was 6.28% (of which taxpayers pay 6.08% and 0.20% is reimbursed by the Department of Treasury) at June 30, 2003. Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated at 1957 market prices. The total real property tax rate in force was 8.28% (of which 8.08% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury) at June 30, 2003.

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4%) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

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

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

**4. Property Taxes (Cont.)**

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

In addition, 1.25% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

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

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these
- iii. Resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

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

**5. Interfund Receivables, Payables and Transfers**

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

Due/advances to:	Due/advances from:					
	Major Funds					
	General Fund	Debt Service Fund	Joint Resolution	Land Acquisition Fund	Other Governmental Funds	Total Governmental Funds
Major funds:						
General fund	-	-	493,507	125,000	136,000	\$ 754,507
Debt services fund	\$ 973	-	-	-	-	973
Joint resolution	161,934	-	-	-	-	161,934
State block grant program	505	-	-	-	-	505
Nonmajor funds:						
Other governmental fund	55,644	-	-	-	-	55,644
						-
Total	\$ 219,056	-	493,507	125,000	136,000	\$ 973,563

Transfer to:	Transfer from:					
	Major Funds					
	General Fund	Debt Service Fund	Joint Resolution	Land Acquisition Fund	Other Governmental Funds	Total Governmental Funds
Major funds:						
General fund	-	172,084	-	-	3,041	\$ 175,125
Debt services fund	-	-	-	-	-	-
Joint resolution	-	-	-	-	-	-
State block grant program	-	-	-	-	-	-
Nonmajor funds:						
Other governmental fund	\$ 97,701	-	-	-	-	97,701
Total	\$ 97,701	172,084	-	-	3,041	\$ 272,826

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

**6. Intergovernmental Receivables and Payables**

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

	Intergovernmental receivable June 30, 2003			Statement of net assets
	Mayor Funds	Other governmental Funds	Total Governmental Funds	
<i>Intergovernmental receivable:</i>				
<i>Grant and Contributions:</i>				
CDBG program fund	-	140,437	140,437	\$ 140,437
Albergue deambulante program fund	-	10,000	10,000	10,000
Ley 52 program fund	-	26,903	26,903	26,903
Maltrato de menores program fund	-	3,252	3,252	3,252
Governmental development bank (CAE)	-	335	335	335
Puerto Rico Treasury Department (Joint Resolution)	-	161,934	161,934	161,934
Puerto Rico Treasury Department (Reimbursement of Christmas bonus)	-	-	-	69,038
Excess of collections over property tax advances	\$ 52,706	-	52,706	52,706
Puerto Rico Electric Power Authority	740,937	-	740,937	740,937
Puerto Rico Electric Power Authority - Special item - general fund	-	-	-	397,193
Total intergovernmental receivable	<u>\$ 793,643</u>	<u>342,861</u>	<u>1,136,504</u>	<u>\$ 1,602,735</u>
<i>Intergovernmental payable:</i>				
Internal Revenues Service (Social Security)	\$ 441,027	-	441,027	\$ 441,027
General Service Administration of the Commonwealth of Puerto Rico	73,317	-	73,317	73,317
Employees Retirement System of the Government of Puerto Rico and Its Instrumentalities	534,492	-	534,492	534,492
Puerto Rico Department of Labor	251,099	-	251,099	251,099
Puerto Rico Treasury Department (General fund)	56,600	-	56,600	56,600
Puerto Rico Aqueduct and Sewer Authority	125,481	-	125,481	125,481
Puerto Rico Electric Power Authority	681,896	-	681,896	681,896
Total intergovernmental payable	<u>\$ 2,163,912</u>	<u>-</u>	<u>2,163,912</u>	<u>\$ 2,163,912</u>

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

**7. Capital Assets**

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

	<b>Balance at June 30, 2002, as restated</b>	<b>Additions, depreciation, and amortization expense</b>	<b>Balance at June 30, 2003</b>
<b>Cost Basis:</b>			
Capital assets, not subject to depreciation and amortization:			
Land	\$ 160,000		\$ 160,000
Construction in progress	7,580,447	1,132,067	8,712,514
<b>Total cost basis of capital assets, not subject to depreciation and amortization</b>	<b>7,740,447</b>	<b>1,132,067</b>	<b>8,872,514</b>
Capital assets, subject to depreciation and amortization:			
Land improvements	818,027		818,027
Buildings, structures, and building improvements	5,202,516		5,202,516
Infrastructure	2,670,333		2,670,333
Other machinery and equipment	308,355	8,214	316,569
Licensed vehicles	1,939,499		1,939,499
<b>Total cost basis of capital assets subject to depreciation and amortization</b>	<b>10,938,730</b>	<b>8,214</b>	<b>10,946,944</b>
<b>Total cost of capital assets</b>	<b>18,679,177</b>	<b>1,140,281</b>	<b>19,819,458</b>
Accumulated depreciation and amortization:			
Land improvements	462,196	25,132	487,328
Buildings, structures, and building improvements	1,118,706	99,400	1,218,106
Infrastructure	1,531,064	42,200	1,573,264
Other machinery and equipment	133,234	14,417	147,651
Licensed vehicles	1,266,005	98,710	1,364,715
<b>Total accumulated depreciation and amortization</b>	<b>4,511,205</b>	<b>279,859</b>	<b>4,791,064</b>
<b>Net capital assets</b>	<b>\$ 14,167,972</b>	<b>\$ 860,422</b>	<b>\$ 15,028,394</b>

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

**7. Capital Assets (Cont.)**

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

General government	\$ 16,888
Public safety	36,100
Urban and economic development	84,766
Health and sanitation	46,514
Public housing and welfare	13,794
Culture, recreation, and education	81,797
Total depreciation and amortization expense	<u>\$ 279,859</u>

**8. Long-Term Obligations**

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

	Balance at June 30, 2002, as restated	Borrowings/ additions	Payments/ deductions	Discount accretion	Balance at June 30, 2003	Due Within One Year
Bonds payables	\$ 4,943,800	-	(335,000)	-	4,608,800	\$ 315,700
Notes payable:						
Puerto Rico Treasury Department(Social Security)	533,052	-	(31,267)	-	501,785	33,196
Puerto Rico Treasury Department(Property Tax advances)	203,419	-	(2,367)	-	201,052	2,519
CRIM (Delinquent Acc)		301,534	-	-	301,534	-
Compensated absences	1,258,029	519,490	-	-	1,777,619	967,272
Claims and judgments	215,167	-	(31,267)	-	180,000	180,000
<b>Total</b>	<u>\$ 7,153,467</u>	<u>821,024</u>	<u>(403,081)</u>	<u>-</u>	<u>7,570,790</u>	<u>\$ 1,498,687</u>

Historically, the general fund has been used to liquidate compensated absences, claims and judgments, and any other long-term liabilities other than long-term debt.

**a) Debt Limitation**

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

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and

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

**8. Long-Term Obligations (Cont.)**

**a) Debt Limitation**

- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10% of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement.

**b) Bonds Payable**

The Municipality issues general obligation and public improvement bonds that can be used to finance the acquisition and construction of capital assets, as well as, to cover certain operating needs.

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

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

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

<u>General obligation bonds:</u>	<u>Outstanding Amount</u>
1999 serial bonds, original issues amount of \$505,000, due in annual principal installments ranging from \$420,000 to \$115,000; plus interest due in semiannually installments at interest rates from 6% to 7.5% through July, 1, 2003	\$115,000
1999 serial bonds, original issues amount of \$680,000, due in annual principal installments ranging from \$45,000 to \$95,000; plus interest due in semiannually installments at 8% through July, 1, 2009	530,000

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**b) Bonds Payable (Cont.)**

**General obligation bonds:**

1999 serial bonds, original issues amount of \$1,010,000, due in annual principal installments ranging from \$70,000 to \$140,000; plus interest due in semiannually installments at rates 8% through July, 1, 2009	785,000
2002 serial bonds, original issues amount of \$570,000, due in annual principal installments ranging from \$10,000 to \$50,000; plus interest due in semiannually installments at rates 5% to 6.5% through July, 1, 2026	560,000
2002 serial bonds, original issues amount of \$2,000,000, due in annual principal installments ranging from \$20,000 to \$175,000; plus interest due in semiannually installments at rates 7% through July, 1, 2026	1,980,000
2002 serial bonds, original issues amount of \$638,800, due in annual principal installments ranging from \$10,700 to \$49,200; plus interest due in semiannual installments at rates 6.5% through July, 1, 2027	<u>638,800</u>
<b>Total general municipal obligation bonds</b>	<b><u>\$ 4,608,800</u></b>

Interest rates on serial bonds subject to variable interest rates are reviewed periodically by Government Development Bank (GDB) and are based on GDB's weighted average rate for its commercial paper program, not to exceed 8%. For financial reporting purposes, the outstanding amounts of bonds represent the total principal to be repaid.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 315,700	223,620	\$ 539,320
2005	211,500	244,220	455,720
2006	227,300	251,363	478,663
2007	243,100	240,035	483,135
2008	269,000	227,631	496,631
2009-2013	869,700	937,219	1,806,919
2014-2018	601,000	744,192	1,345,192
2019-2023	863,800	516,217	1,380,017
2024-2028	1,007,700	181,999	1,189,699
Total	<u>\$ 4,608,800</u>	<u>3,566,495</u>	<u>\$ 8,175,295</u>

At June 30, 2003, accrued interest payable on bonds amounted to \$108,791.

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

*c) Notes Payable to Puerto Rico Treasury Department (Social Security)*

On May 21, 1999, the Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay the debt related to social security tax from 1982 to 1986. The original face amount of the note was \$936,377, which is due in monthly principal installments of \$5,200, at an implicit interest rate of 6.00% through May 2014. Outstanding balance at June 30, 2003 is net of the unamortized discount. The outstanding principal and interest balances of the note payable amounted to \$501,784 and \$184,993, respectively, at June 30, 2003. The principal and interests maturities are as follows:

<b>Year Ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2004	\$ 33,196	29,204	\$ 62,400
2005	35,243	27,157	62,400
2006	37,417	24,983	62,400
2007	39,725	22,675	62,400
2008	42,175	20,225	62,400
2009-2013	253,255	58,745	312,000
2014-2018	60,774	2,004	62,778
<b>Total</b>	<b>\$ 501,785</b>	<b>184,993</b>	<b>\$ 686,778</b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

*e) Notes Payable to Puerto Rico Treasury Department (Property tax advances)*

On July 03, 2001, the Municipality entered into a financing agreement with the CRIM to pay the debt related to the excess of property tax advances over collection made by CRIM. The original face amount of the note was \$201,052, which is due in monthly principal installments of \$1,252, at an implicit interest rate of 6.255% through July 2033. Outstanding balance at June 30, 2003 is net of the unamortized discount. The outstanding principal and interest balances of the note payable amounted to \$201,052 and \$235,892, respectively, at June 30, 2003. The principal and interests maturities are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 2,519	12,505	\$ 15,024
2005	2,681	12,343	15,024
2006	2,854	12,170	15,024
2007	3,038	11,986	15,024
2008	3,233	11,791	15,024
2009-2013	19,570	55,550	75,120
2014-2018	26,734	48,386	75,120
2019-2023	36,521	38,599	75,120
2024-2028	48,889	25,321	75,120
2029-2033	54,013	7,331	61,344
Total	<u>\$ 201,052</u>	<u>235,892</u>	<u>\$ 436,944</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

**g) Payable to CRIM (Delinquent accounts)**

On March 19, 2002, the Resolution Num. 36 Serie 2001-2002 was enacted which authorized the Municipality to obtain up to \$301,534, for a term not exceeding 30 years, for the repayment of bonds issued for the sale of delinquent accounts. The repayment agreement bears interest at variable rates (beginning in 6.50% at June 30, 2003). The outstanding principal and accrued interest balances of the note payable to CRIM amounted to \$301,534 and \$407,256, respectively, at June 30, 2003. The principal and interest maturities are as follows:

<b>Year Ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2004	\$ -	19,600	\$ 19,600
2005	-	19,600	19,600
2006	-	19,600	19,600
2007	-	19,600	19,600
2008	-	19,600	19,600
2009-2013	28,458	93,700	122,158
2014-2018	39,353	82,805	122,158
2019-2023	54,418	67,740	122,158
2024-2028	75,250	46,908	122,158
2029-2033	104,055	18,103	122,158
Total	<u>\$ 301,534</u>	<u>407,256</u>	<u>\$ 708,790</u>

**i) Compensated Absences**

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

	<b>Due Within One Year</b>	<b>Due After One Year</b>	<b>Total</b>
Vacation and sick leave	\$ 711,184	810,347	\$ 1,521,531
Compensatory time	256,088	-	256,088
Total	<u>\$ 967,272</u>	<u>810,347</u>	<u>\$ 1,777,619</u>

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

**9. Employees' Retirement Systems**

*a) Plan Description*

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

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

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

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

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension program ("System 2000").

System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons employed on or after January 1, 2000, are only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the System, together with those of the current defined benefit plan.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

**9. Employees' Retirement Systems (Cont.)**

**a) Plan Description**

Benefits at retirement are not guaranteed by the Commonwealth of Puerto Rico or the Municipality. The annuity is based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the participant' salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note; (2) earn a rate equal to 75% of the return of ERS's investment portfolio (net of management fees); or (3) earn a combination of both alternatives.

Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275% of the participant' salary) will be used to fund the current plan.

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

On August 12, 2000, Act No. 174 was approved to allow certain participants of ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by ERS. In the cases, the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

Historically, the Commonwealth of Puerto Rico has reported ERS and System 2000 in its basic financial statements. Accordingly, the Commonwealth of Puerto Rico is currently assuming any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates detailed below.

**b) Funding Policy**

Contribution requirements are established by law and are as follows:

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**9. Employees' Retirement Systems (Cont.)**

*c) Annual Pension Cost and Net Pension Obligation*

The net pension obligation and the annual pension cost of ERS and System 2000 as of and for the year ended June 30, 2002 (most recent data available), which include the employees of the Municipality, the Commonwealth of Puerto Rico and other municipalities, has been recorded in the basic financial statements of the Commonwealth. No allocation of such amounts has been made in the accompanying basic financial statements. The following aggregate annual pension cost and net pension obligation as of and for the year ended June 30, 2002 (most recent data available) which are assumed and accounted for by the

Commonwealth is presented only for the purposes of additional analysis (amounts expressed in thousands):

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

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

Date of latest actuarial valuation:	July 1, 2001
Actuarial cost method:	Projected unit credit cost
Amortization cost method:	Level percentage of projected payroll
Remaining amortization period:	25 years
Amortization approach:	Closed
Asset valuation method:	Market Value
Actuarial assumptions:	
Inflation	3.50%
Investment rate of return	8.50%
Projected salary increases per annum	5.00%
Cost-of-living adjustments	3.0% every three years

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**9. Employees' Retirement Systems (Cont.)**

***d) Three-Year Trend Information***

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

**Annual pension cost (APC):**

Year ended June 30, 2002	\$ 860,082
Year ended June 30, 2001	803,526
Year ended June 30, 2000	768,76

**Percentage of APC contributed:**

Year ended June 30, 2002	35.8%
Year ended June 30, 2001	65.6%
Year ended June 30, 2000	35.8%

**Net pension obligation:**

Year ended June 30, 2002	\$ 2,815,576
Year ended June 30, 2001	2,263,722
Year ended June 30, 2000	2,010,051

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**10. Deferred Revenues**

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

	Major Funds				Total Governmental Funds	Statement of net assets
	General Fund	Joint Resolution Fund	State Block Grant Fund	Other Governmental Funds		
<b>Measurable but not available revenues:</b>						
Property taxes	\$ 566,821				566,821	
Excess of collections over property tax advances	52,706				52,706	
Municipal license taxes	367,427				367,427	\$ 367,427
Puerto Rico Electric Power Authority (Lieu tax)	59,041				59,041	6,443
Total revenues	<u>1,045,996</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,045,996</u>	<u>373,871</u>
<b>Unearned revenues:</b>						
<b>Intergovernmental grants and contributions:</b>						
U.S. Department of Health and Human Services:						
Child Care USDA food fund				16,761	16,761	16,761
Child Care program fund				14,891	14,891	14,891
U.S. Department of Housing and Urban Development						
Section 8				1,216	1,216	1,216
UDAG				137,256	137,256	137,256
U.S. Department of Defense						
COPS				7	7	7
Other governmental agencies				2,911	2,911	2,911
					-	
Total unearned revenues				<u>173,040</u>	<u>173,040</u>	<u>173,040</u>
Total deferred revenues	<u>\$ 1,045,996</u>	<u>-</u>	<u>-</u>	<u>173,040</u>	<u>1,219,036</u>	<u>\$ 546,911</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**11. Commitments and Contingencies**

**a) Commitments**

As of June 30, 2003, the Municipality has several outstanding or planned non-cancelable construction projects amounting to \$8,683,574, of which \$4,070,489 have been incurred and paid as of June 30, 2003, and \$4,613,085 remain outstanding to incur through the end of each project. These projects are evidenced by contractual commitments with contractors and are accounted for in the capital projects fund.

**b) Contingencies**

The Municipality is defendant in numerous claims and legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1995, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation, as well as assume the payment for any judgment that may be entered against them. There is no limitation on the payment of such judgments. With respect to pending and threatened litigation, the Municipality has reported liabilities amounting to \$180,000 for awarded and anticipated unfavorable judgments at June 30, 2003. This amount was included as a current portion of long term obligation in the accompanying statement of net assets, and represents the amount estimated as a probable liability or a liability with a fixed or expected due date, when will require future available financial resources for its payment. Management believes that the ultimate liability in excess of amounts recorded in the accompanying statement of net assets, if any, would not be material to the basic financial statements taken as a whole.

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements  
June 30, 2003

**12. Accounting Changes, Changes in Reporting Entity and Restatements**

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

GASB No. 38 requires certain note disclosures when GASB No. 34 is implemented. The provisions of this new standard have been incorporated into the basic financial statements and notes.

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

These new standards caused most of the accounting changes, changes in reporting entity, and restatements described on the ensuing discussion below. Changes and restatements for reasons other than the adoption of the above pronouncements are also explained below. The following schedule reconciles the June 30, 2002 fund balance as previously reported by the Municipality to the beginning fund balance, as restated:

	June 30,2002 fund balance as previously reported	Fund reclassification	Correction of accounting errors and others adjustments	June 30,2002 fund balance, as restated
Major funds:				
General fund	\$ (2,472,697)	(288,789)		\$ (2,761,486)
Major special revenue fund:				
Land adquisition fund	-	1,200,000		1,200,000
State block grant program	-			-
Joint Resolution funds	206,352	274,951		481,303
Debt services funds	638,509	(359,802)		278,707
Other non major funds:				
Other governmental fund	260,329	(119,275)		141,054
<b>Total governmental fund</b>	<b>\$ (1,367,507)</b>	<b>707,085</b>		<b>\$ (660,422)</b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

**12. Accounting Changes, Changes in Reporting Entity and Restatements (Cont.)**

Upon the adoption of GASB No. 34, the Municipality corrected certain reclassification and adjustments reported in the prior year's governmental funds. These reclassifications and adjustments consist principally in the effect of not adopting the provisions of GASB No. 33 prior to June 30, 2002, as required by GAAP. The reclassification and adjustments in the general fund include the correction of an understatement in cash balances of the general fund.

**13. Subsequent Events**

On September 2, 2003 the Municipal Legislature approved the issuance of municipal special obligation bond amounting to \$670,000. The proceeds of these bonds will be used for the payment of suppliers. These serial bonds are dated July 1, 2003 and are due in annual principal installments ranging from \$10,000 to \$50,000, plus interest (at variable rates) due in biannual installments through July 1, 2028.

**14. Special Item**

In December 2000, the Municipality and the other municipalities of Puerto Rico filed a complaint against the Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth, in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenged the application by PREPA of the "net revenues" formula, which reduced the amount available to pay contributions in lieu of taxes, and energy sales aside for the Municipality. On March 18, 2003, the Board of Directors of PREPA approved a resolution by which PREPA agreed to settle the claims with all municipalities. Accordingly, PREPA offered to pay \$125 million to all municipalities to settle the claim, which are divided in \$68 million in cash and \$57 million in the construction of electric infrastructure projects in on behalf of the municipalities. Of such amount, the Municipality will receive \$397,193 in cash and \$332,941 in the future construction projects. At June 30, 2003, an intergovernmental receivable from PREPA amounting to \$397,193 has been recorded in the general fund and the government-wide statement of net assets to recognize the settlement to be collected by the Municipality from PREPA. This transaction falls under the definition of special item set forth by GASB No. 34, as it is a transaction of unusual and infrequent nature within the control of the Municipality's management. Accordingly, the accompanying statement of activities includes a special item of \$324,179 recorded in the government-wide statement of activities, which represents the net benefit to be collected from PREPA, after deducting professional fees amounting to \$73,013 (recorded within account payable in the government-wide statement of net assets) to be paid to the Municipality's legal counselors. In the accompanying governmental funds' balance sheet, deferred revenues of \$397,193 has been recorded at June 30, 2003 since the receivable from PREPA is not considered a current available financing resource at June 30, 2003.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**  
Statement of Revenues and Expenditures - Budget and Actual  
Budgetary Basis - General Fund  
Year ended June 30, 2003

	Budgeted Amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget - over (under)
	Original	Final		
<b>Revenues:</b>				
Property taxes	\$1,542,317	1,542,317	1,670,891	\$ 128,574
Municipal license taxes	464,000	464,000	444,791	(19,209)
Charges for services	215,479	215,479	190,300	(25,179)
Intergovernmental grants and contributions	3,929,347	3,929,347	3,209,212	(720,135)
Federal financial assistance	-	-	-	-
Rent of property	10,000	10,000	7,783	(2,217)
Investment earnings	36,000	36,000	4,211	(31,789)
Miscellaneous	221,300	221,300	439,016	217,716
<b>Total revenues</b>	<u>6,418,443</u>	<u>6,418,443</u>	<u>5,966,204</u>	<u>(452,239)</u>
<b>Expenditures:</b>				
<b>Current:</b>				
General government	3,062,151	3,062,151	2,728,062	334,089
Urban and economic development	1,280,488	1,280,488	1,267,179	13,309
Public safety	942,428	942,428	946,748	(4,320)
Health and sanitation	588,246	588,246	805,442	(217,196)
Culture, recreation, and education	224,513	224,513	248,405	(23,892)
Public housing and welfare	320,617	320,617	369,772	(49,155)
<b>Capital outlays</b>	-	-	-	-
<b>Total expenditures</b>	<u>6,418,443</u>	<u>6,418,443</u>	<u>6,365,608</u>	<u>52,835</u>
<b>Excess (deficiency) of revenues over expenditures</b>	<u>\$ -</u>	<u>-</u>	<u>(399,404)</u>	<u>\$ (399,404)</u>

**Explanation of Differences:**

**Sources/inflows of financial resources:**

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$5,966,204
<b>Differences - budget basis to GAAP:</b>	
Net increase in receivables	426,618
Resources considered revenues for budgetary purposes but are not revenues for financial reporting purposes	204,792
Proceeds from issuance of long-term debt considered revenues for financial reporting but not for budgetary purposes	97,701
<b>Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds</b>	<u>\$6,695,315</u>

**Uses/outflows of financial resources:**

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$6,365,608
<b>Differences - budget basis to GAAP:</b>	
Net increase in payables	849,109
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(175,125)
Outflows of budgetary resources used for financing expenditures that are not expenditures for budgetary purposes	310,765
<b>Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds</b>	<u>\$7,350,357</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

Notes to Basic Financial Statements

June 30, 2003

Excess (deficiency) of revenues and other financing sources over expenditures and other financing sources - budgetary basis	\$ (399,404)
Timing differences:	
Add:	
Current year encumbrances recorded as expenditures for budgetary purposes	1,653,298
Deduct:	
Prior year encumbrances recorded as current year expenditures for GAAP purposes	(1,563,869)
Entity differences:	
Non-budgeted expenditures	-
Basis of accounting differences:	
Net increase in property tax receivable	215,388
Net increase in municipal license tax receivable	19,975
Net increase in intergovernmental receivables	141,245
Net increase in due from other funds	50,010
Net increase in accounts payable and accrued expenses	(160,643)
Net increase in intergovernmental payables	(357,583)
Net increase in due to other funds	(93,265)
Net increase in deferred volume of business tax	(15,303)
Net increase in deferred intergovernmental revenues	(222,315)
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses (GAAP basis)	<u>\$ (732,466)</u>

**MUNICIPALITY OF QUEBRADILLAS  
COMMONWEALTH OF PUERTO RICO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE YEAR ENDED JUNE 30, 2003**

FEDERAL GRANTOR/PASS THROUGH GRANTOR PROGRAM TITLE	<u>FEDERAL CFDA NUMBER</u>	<u>EXPENDITURES</u>
<b>COMMUNITY PLANING AND DEVELOPMENT</b>		
Housing Choice Voucher	14.855	\$ 665,829
Housing Opportunities for Persons with Aids	14.241	<u>103,426</u>
Total Community Planing and Development		<u>769,255</u>
<b>PASSED THROUGHT PR MUNICIPAL SERVICES ADMINISTRATION BLOCK GRANT- NON ENTITLEMENT</b>		
Community Development Block Grant	14.218	1,982,074
<b>DEPARTMENT OF AGRICULTURE</b>		
Fish Wild Life Serv.		26,479
<b>US DEPARTMENT OF HEALTH AND HUMAN SERVICE</b>		
Child Care	93.575	62,011
<b>OTHER FEDERAL PROGRAMS</b>		
Federal Emergency Management Agency	83.544	133,880
<b>TOTAL FEDERAL FINANCIAL ASSISTANCE</b>		<b><u>\$ 2,973,699</u></b>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**  
**Notes to Schedule of Expenditure of Federal Awards**  
**Fiscal Year Ended June 30, 2003**

**1. GENERAL**

The accompanying schedule of expenditures of federal awards presents the expenditure of all the federal financial assistance programs of the municipality of Quebradillas (the Municipality). The Municipality's reporting entity is defined in note 1 to the Municipality's general- purpose financial statement.

**2. BASIS OF ACCOUNTING**

The accompanying schedule of expenditures o federal awards is presented using modified- accrual accounting basis of accounting, which is described in note 1 to the Municipality's general purpose financial statement.

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

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

I have audited the financial statements of the Municipality of Quebradillas as of and for the year ended June 30, 2003, and has issued my report thereon dated July 14, 2004. I conducted my audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the Municipality of Quebradillas financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs items 03-01 and 03-02.

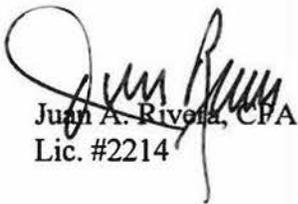
**Internal Control Over Financial Reporting**

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

However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the Municipality of Quebradillas 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 as items 03-01 and 03-02.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weakness. However, I believe that none of the reportable conditions described above is a material weakness.

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

  
Juan A. Rivera, CPA  
Lic. #2214



December 30, 2003  
Toa Baja, Puerto Rico

Stamp NO. 2010566 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report

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

To the Honorable Mayor and  
the Municipal Assembly  
Municipality Quebradillas  
Quebradillas, Puerto Rico

**Compliance**

I have audited the compliance of Municipality of Quebradillas with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2003. The Municipality of Quebradillas major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Municipality of Quebradillas management. My responsibility is to express an opinion on the Municipality of Quebradillas compliance based on my audit.

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

As describe in items 03-01 and 03-02, in the schedule of finding and questioned cost the Municipality of Quebradillas did not comply with requirements regarding accounting system and cash management respectability

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

## Internal Control Over Compliance

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

My consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components do 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.

I noted certain matters involving the internal control over compliance and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in my judgment, could adversely affect the Municipality of Quebradillas ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions describe in the accompanying schedule of findings and questioned costs in items 03-01, 03-02 and 03-03.

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

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

  
Juan A. Rivera, CPA  
Lic. #2214

December 16, 2002  
Toa Baja, Puerto Rico



NOTE: Stamp No. 2010567 of the Puerto Rico State Society of Certified Public Accountants was affixed to the original of this report.



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

**FINDING NUMBER 03-01**

**Accounting System**

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

**Recommendation**

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

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

**a. Governmental Funds**

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

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

**FINDING NUMBER 03-01 (CONT.)**

**Accounting System**

1) **General**

This is the operational fund for the Municipality. It accounts for all financial resources except those required to be accounted for in another funds.

2) **Special Revenue**

Is used to account for the proceeds of specific revenue sources (other than expendable trust or major capital projects) that are legally restricted for expenditure for specific purposes.

3) **Debt Service**

Is used to account for the accumulation of resources for, and the payment of, general long term debt, principal, interest and, related costs.

4) **Capital Project**

Is used to account for financial resources to be used for the construction or acquisition of major capital facilities (other than those financed by proprietary and trust funds).

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

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

**b. Proprietary Fund**

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

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

**FINDING NUMBER 03-01 (CONT.)**

**Accounting System**

**c. Trust and Agency Fund**

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

**d. Account Groups**

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

**1) General Fixed Assets account group**

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

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

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

The Municipality's accounting system should provide for the segregation of the encumbrances from accounts payable. Encumbrances represent commitments related with a service to be received or a good to be acquired.

This amount should be accumulated in an account named Fund Balance Reserved for Encumbrances at the time the purchase order is issued. The amount of Encumbrances should be reserved for each fund balance since no bilateral agreement exists. The accounts payable and expenses should be recorded when the debt is incurred and the amount is determinable.

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

**FINDING NUMBER 03-01 (CONT).**

**Auditee Response:**

The Finance Department is working together with "OCAM" the agency in charge to supervise the municipalities finance in P.R. to revise the current Accounting System to implement new Accounting System.

**FINDING NUMBER 03-2**

**Bank Accounts and Cash Management**

**Condition**

At June 30, 2003, the bank reconciliation showed overpayment and the differences with the banks balance; for the following reasons;

1. Interest for over Draft
2. Charges for stop payments
3. Charges for checks Issue with insufficient funds.
4. Electronic transference without book recording.
5. Cancelled checks without books adjustments
6. Interest earned during the periods.
7. Adjustment by returned checks.

**Criteria**

The chapter IV sections 9 and 10 of "reglamento de normas basicas para los municipios de PR" stated;

- a. The municipality must show the Bank Balance available in the General Account.

**Cause of condition**

The Municipality has not established sufficient controls in the handling of bank accounts to prevent errors and irregularities from being timely detected. In addition, the Municipality has not established effective cash management controls.

**Effect of condition**

Error or irregularities might occur and not be timely detected.

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

**FINDING NUMBER 03-2 (CONT.)**

**Bank Accounts and Cash Management**

**Recommendation** All bank accounts must be reconciled every month and all reconciling differences if any, must be investigated and adjusted accordingly.

**Auditee Response:** This finding was corrected partially and the Director of Finance are in the process to record all of the adjustments before December 2004.

**FINDING NUMBER 03-3**

The following deficiencies were found in the Governmental accounts.

**Condition** Municipality outstanding debt with different Governmental entities (Department of Labor Internal Revenues Services and Water and server Authority); also the amounts withheld to employees for social security retirement system Health Insurance and payments to employee's loan are retained and expended by the municipality.

**Criteria** Law # 81 Article 7.003 established that is mandatory create budget assignments for legally outstanding debts of the municipalities that not included in previous budget. Law number 101 of June 24, 1977, labor law of PR established that is obligatory that all employer submitted quarterly return and pay the accrued labor taxes before the 30 of next month after the quarter. Then is contrariety to the law retain and used amounts withheld to employees for different purposes.

**Cause of condition** The Municipality did not included in budget outstanding debts from prior periods of the year audited; and the Municipality did not prepared the labor tax return and neither made the deposits to department of labor and PR retirement system.

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

**FINDING NUMBER 03-3 (CONT.)**

<b>Effect of condition</b>	The Municipality were forced to pay interest and penalties reducing the resources of the Municipality.
<b>Recommendation</b>	The Municipality are obligated to include in the next operational budget all of this accounts balance or analyze the possibility of financing all of this debts trough loan term loan with BGF.
<b>Auditee Response</b>	The municipality management are under the process to Finance the majority of outstanding debts with different agencies through long term loan with Governmental Bank. This loan expected to be obtained by the end of third quarter 2004.

**FINDING NUMBER 03-4**

**Purchasing and Receiving**

**Condition** My review of twenty three (17) disbursement vouchers for municipality general fund and twelve (10) for federal funds revealed noncompliance with applicable internal control requirements. My review of the supporting documentation revealed the following documents were missing or incomplete:

<b>Description</b>	<b>Municipality <u>Funds</u></b>	<b>Federal <u>Funds</u></b>
a. Receiving materials and Service before purchase order	3	
b. Receiving and inspection sheets not prepared	2	
c. Invoice without certification	4	
d. Documents without signature of pre-interceptor official	1	
f. Voucher without budget account		3

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

**FINDING NUMBER 03-4 (CONT.)**

**Criteria**

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

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

Such regulation establish among other things that:

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

**Auditee Response:**

The Director of Finance gave specific instructions to the employee that pre-audit the disbursement document to enforce the current disbursement procedure to avoid this finding in the future.

**Purchasing and Receiving  
Cause of condition**

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

**Effect of condition**

The Municipality did not comply with the regulation mentioned above.

**Recommendation**

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

**Auditee Response**

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

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

**FINDING NUMBER 03-5**

**Revenues / Accounts Receivable**

**Condition**

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

- a. 2 of 25 taxpayer file did not have evidence of income tax return.
- b. 2 of 25 taxpayer file did not oath the volume of Business Tax.
- c. 1 of 10 that volume of business exceed one million dollars, did not include Audited Financial Statements as required by law.

**Criteria**

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

In addition, the Municipality must maintain adequate controls over volume of business taxes receivable and shall establish an effective system of accounts receivable recording.

**Cause of condition**

This situation cause that the data that could be obtained from the system be unreliable and that the Municipality does not have a good control over the levy and / or collection of taxes.

**Effect of condition**

The amount of volume of business tax received or receivable were not properly documented.

**Recommendation**

The Municipality must establish the necessary procedures to have in place a computerized system to levy the volume of business tax and record accounts receivable and use this data in the collection process.

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

**FINDING NUMBER 03-5 (CONT.)**

**Revenues / Accounts Receivable**

**Auditee Response**

The Director of Finance instructed the employee in charge of collection, to under any circumstances prepare or authorized the preparation of volume of business certificate without the proper documentation.

**FINDING NUMBER 03-6**

**Personnel Files**

**Condition**

My review of twenty (24) personnel files for the year under audit, revealed the following instances where the required documents, were not found:

<b><u>Documents</u></b>	<b><u>Exceptions</u></b>
a. Medical history	5
b. Employees Application	15
c. Withholding form	10
d. Photo 2x2	4
e. Evaluation form	24
f. Drug free workplace letter	24
g. Evidence of accumulated hours of training	24
h. Governmental ethic law were discussed with the employees	24
i. Certification or evidence of educational level.	17

In addition, the following deficiencies were found:

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

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

**FINDING NUMBER 03-6 (CONT.)**

**Personnel Files**

**Criteria**

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

The Municipality should provide adequate procedures for determining reasonableness, allocability and allowability of costs in accordance with State regulations and the provisions of OMB Circular A-87.

Furthermore, Attachment B, Section 10 of OMB Circular A-87 establishes that amounts charged to grant programs for personal services will be based on payrolls documented and provided in accordance with generally accepted practices of the State. Payroll must be supported by time and attendance records for individual employees.

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

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

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

**Cause of condition**

Carelessness of personnel in charge of maintaining personnel files and lack of knowledge of prescribed regulations.

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

**FINDING NUMBER 03-6 (CONT.)**

**Personnel Files**

**Effect of condition**

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

**Recommendation**

A comprehensive plan must be developed to ensure that all the personnel files be on hand and complete in order to comply with the prescribed guidelines. Also, further steps should be taken to ascertain that all OCAP reports are prepared and processed immediately. Additionally, further steps should be taken to ensure compliance with federal regulations.

**Auditee Response**

The mayor instructed the Director of Personnel to immediately purge all of the employee's record to ensure that employees files are completed as required by the law and the internal control system of the municipality

**FINDING NUMBER 03-7**

**Bids**

**Condition**

As part of my examination of the bids procedures of the Municipality, I requested the file and documents for twenty fourth (15) bids granted during the year. The following summarizes the deficiencies found:

- a. 1 of 15 the contract did not provided the income tax retention for professional services. According income tax law.
- b. 2 of 15 the contract did not have the clause that will pay alimony.
- c. 1 of 15 the contract did not provided for the budget account from which the service will be pay.
- d. 1 of 15 the contract did not provided clause for cancel by negligence of the contracting.

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

**FINDING NUMBER 03-7 (CONT.)**

**Condition (Cont.)**

- e. 4 of 15 the contract did not include the clause that mentioned the circular letter
- f. Professional Services to work 20 hours semimonthly did not incurred detail of the work performed; (only include the date and the hours).
- g. 2 of 24 the contract did not include the clause that the maximum hours to be work.
- h. 5 of 24 the contract did not included the clause that invoices received after eight of each month will be pay the next month.
- i. 4 of 24 the contract did not have the clause, that the person did not receive payment of other governmental entity.

**Criteria**

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

**Cause of condition**

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

**Effect of condition**

The Municipality did not comply with the regulations mentioned above.

**Recommendation**

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

**Auditee Response**

The mayor instructed the legal counselor and the municipality secretary to included in every municipality contract the clauses required by the office of P.R. controller in benefit of municipality interest.

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

**FINDING NUMBER 03-8**

**“Liquidación Presupuestaria”**

**Condition**

The “Liquidación Presupuestaria” was not prepared in the due date required by law.

During the performance of my procedures the following exceptions were noted:

- a. The “ Liquidación Presupuestaria” must be submitted to the office of the Commissioner of Municipal Affairs (OCAM) not later than September 30, of each year, as of the date of this report the municipality have not comply with this requirement

**Effect of condition**

Financial information submitted to “OCAM” do not present fairly the operations of the Municipality.

**Recommendation**

The director of finance should be established the regulation that the “Liquidación Presupuesaria” prepare according to “Reglamento de Normas Basicas” Chapter 2 section 10

**Auditee Response**

The mayor instructed the Director of Finance to work with this report in efficiency manner to comply with the dead line established by law. This finding must be corrected for fiscal year ended June 30, 2004.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

The Municipality of Quebradillas has been the subject of various audits and program monitoring compliance over the past years. Following is a summary of audit findings for which final determination and/or corrective action are in process. These findings still prevail for the year ended June 30, 2003. This summary included a brief description of the findings and their status. Therefore, findings included in the audit report for the year ended June 30, 2003, encompass unresolved findings mentioned in the audit for the fiscal year ended June 30, 2003, date July 12, 2004.

**FINDING NUMBER 02-01**

**Accounting System**

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

**Recommendation**

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-01 (CONT.)**

**a. Governmental Funds**

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

1) General

This is the operational fund for the Municipality. It accounts for all financial resources except those required to be accounted for in another funds.

2) Special Revenue

Is used to account for the proceeds of specific revenue sources (other than expendable trust or mayor capital projects) that are legally restricted for expenditure for specific purposes.

3) Debt Service

Is used to account for the accumulation of resources for, and the payment of, general long term debt, principal, interest and, related costs.

4) Capital Project

Is used to account for financial resources to be used for the construction or acquisition of major capital facilities (other than those financed by proprietary and trust funds).

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-01 (CONT.)**

**Accounting System**

**b. Proprietary Fund**

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

**c. Trust and Agency Fund**

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

**d. Account Groups**

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

1) General Fixed Assets account group

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

2) General Long-term Debt accounts group

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

The Municipality's accounting system should provide for the segregation of the encumbrances from accounts payable. Encumbrances represent commitments related with a service to be received or a good to be acquired.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-01 (CONT.)**

**Accounting System**

This amount should be accumulated in an account named Fund Balance Reserved for Encumbrances at the time the purchase order is issued. The amount of Encumbrances should be reserved for each fund balance since no bilateral agreement exists. The accounts payable and expenses should be recorded when the debt is incurred and the amount is determinable.

**Status**

Still Prevails

**FINDING NUMBER 02-2**

**Accounting Records**

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

**Accounting Records**

- a. The balance of the cash transactions report (From 4A), does not agree with various accounts and their respective bank account's reconciliation.
- b. The bank reconciliation for the operating account was not prepared on a timely basis.
- c. The Municipality maintains several cash accounts which are either inactive or have limited activity.
- d. There were various unreconciled material differences between the accounting records of the different funds.
- e. No reconciliation is made general ledger, cash reports, bank reconciliation, and other related subsidiaries and reports. There are material and unreconciled differences between these reports and ledgers.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-2 (CONT.)**

**Recommendation**

I recommend to the Municipality to maintain a good internal control system in order that all income and expenditure transactions will be record on accounting books correctly; given special treatment to the special funds management by the Municipality. Moreover, the Municipality must to prepare the bank reconciliation of all accounts of the Municipality as required by the Law of Autonomy Municipality on Chapter 8, Article 8.10(j).

**Status**

Still Prevails

**FINDING NUMBER 02-03**

**Fixed Assets**

During the audit I noted that:

- a. The additions to the property ledger had been recorded on a cash basis, instead on the accrual basis.
  - b. There is no supervision process established in order to verify if each department keeps adequate control of the property that is under their responsibility.
  - c. Expenditures for financing charges of issued long-term debts, and financing charges related to property, plant and equipment had not been recorded in the property ledger.
  - d. The is no supervision process to verify if each department keeps adequate control of the inventory.
2. The Municipality does not maintain a proper record of personal property acquired with Municipal funds.
  3. A physical inventory was not taken at year-ends.

**Recommendation**

To improve the internal controls in the area of property, the Property Custodian in coordination with the Finance Director should implement the following procedures:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-03(CONT.)**

**Recommendation**

- a. It is recommended to take a physical inventory once a year. Any discrepancies found should be investigated and proper action taken.
- b. The Department of Property must perform periodical surprise physical observations and / or verification of the related assets to determine their existence and condition.
- c. The Department of Property must record the expenditures for financing charges of issued long-term debts.
- d. It is recommended to reconcile periodically the expenditures recorded by the Finance Department and the amount recorded by the Department of Property. Any discrepancies found should be investigated.

**Status**

Corrected

**FINDING NUMBER 02-4**

**Bank Accounts and Cash Management**

**Condition**

At June 30, 2002, the bank reconciliation showed overpayment and the differences with the bank.

**Status**

Still Prevails.

**FINDING NUMBER 02-5**

The following deficiencies were found in the Governmental accounts.

**Condition**

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

**Status**

Still Prevails

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-5 (CONT.)**

**Disbursement**

**Condition**

My review of twenty three (23) disbursement vouchers for municipality general fund and twelve (12) for federal funds revealed noncompliance with applicable internal control requirements. My review of the supporting documentation revealed the following documents were missing or incomplete:

<b>Description</b>	<b>Municipality <u>Funds</u></b>	<b>Federal <u>Funds</u></b>
a. Receiving materials and Service before purchase order	5	
b. Requisition form not found	3	
c. Quotation not found	2	
d. Receiving and inspection sheets not prepared	4	
e. Invoice without certification	6	
f. Documents without signature of pre-interceptor official	4	12
g. Voucher without budget account		7

**Status:**

Still Prevails

**Purchasing and Receiving**

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

Such regulation establish among other things that:

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

**Status**

Still Prevails

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-7**

**Revenues / Accounts Receivable**

**Condition**

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

- a. 3 of 25 taxpayer file did not have evidence of income tax return.
- b. 17 of 25 taxpayer file did not oath the volume of Business Tax.

**Status**

Still Prevails

**FINDING NUMBER 02-8**

**Personnel Files**

**Condition**

My review of twenty (20) personnel files for the year under audit, revealed the following instances where the required documents, were not found:

<u>Documents</u>	<u>Exceptions</u>
a. Medical history	18
b. Employees Application	16
c. Withholding form	19
d. Copy of Social Security	1
e. Health Certification	1
f. Form I -9	2
g. Evaluation form	20
h. Drug free workplace letter	20
i. Oath and notification form	2
j. Evidence of accumulated hours of training	20
k. Governmental ethic law were discussed with the employees	20

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02-8 (CONT.)**

**Personnel Files**

**Condition**

In addition, the following deficiencies were found:

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

**Status**

Still Prevails

**FINDING NUMBER 02-9**

**Bids**

**Condition**

As part of my examination of the bids procedures of the Municipality, I requested the file and documents for twenty fourth (24) bids granted during the year. The following summarizes the deficiencies found:

- f. 1 of 24 the contract did not provided the income tax retention for professional services. According income tax law.
- g. 2 of 24 the contract did not have the clause that will pay alimony.
- h. 1 of 24 the contract did not provided for the budget account from which the service will be pay.
- i. 1 of 24 the contract did not provided clause for cancel by negligence of the contracting.
- j. 4 of 24 the contract did not include the clause that mentioned the circular letter
- f. 2 of 24 the contract did not include the clause that the maximum hours to be work.
- g. 5 of 24 the contract did not have hand over after 8 day will be pay the next month.
- h. 4 of 24 the contract did not have the clause, that the person did not receive payment of other entity.

**Status**

Still Prevails

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 02 – 10**

**“Liquidación Presupuestaria”**

**Condition**

The “Liquidación Presupuestaria” was not properly prepared.

During the performance of my procedures the following exceptions were noted:

- a. The “ Liquidación Presupuestaria” must be submitted to the office of the Commissioner of Municipal Affairs (OCAM) not later than September 30, of each year, as of the date of this report the municipality have not comply with this requirement

**Status**

Still Prevails

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEARS ENDED JUNE 30, 2003**

**FINDING NUMBER 01-1**

**Accounting System**

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

**Status:**

Still Prevails

**FINDING NUMBER 01-2**

**Accounting Records**

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

- a. The balance of the cash transactions report (From 4A), does not agree with various accounts and their respective bank account's reconciliation.
- b. The bank reconciliation for the operating account was not prepared on a timely basis.
- c. The Municipality maintains several cash accounts which are either inactive or have limited activity.
- d. There were various unreconciled material differences between the accounting records of the different funds.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**  
**SUMMARY SCHEDULE AND PRIOR AUDIT FINDINGS** 04-5016  
**FISCAL YEAR ENDED JUNE 30, 2003**

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**FINDING NUMBER 01-2 (CONT.)**

**Accounting Records**

- e. No reconciliation is made general ledger, cash reports, bank reconciliation, and other related subsidiaries and reports. There are material and unreconciled differences between these reports and ledgers.

**Status:** Corrected

**FINDING NUMBER 01-3**

**Fixed Assets**

During the audit I noted that:

- a. The additions to the property ledger had been recorded on a cash basis, instead on the accrual basis.
  - b. There is no supervision process established in order to verify if each department keeps adequate control of the property that is under their responsibility.
  - c. Expenditures for financing charges of issued long-term debts, and financing charges related to property, plant and equipment had not been recorded in the property ledger.
  - d. There is no supervision process to verify if each department keeps adequate control of the inventory.
2. The Municipality does not maintain a proper record of personal property acquired with Municipal funds.
  3. A physical inventory was not taken at year-ends.

**Status:** Corrected