

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

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

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UNIDAD DE CORREO
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)**

FISCAL YEAR ENDED JUNE 30, 2004

Conf. No. 5-9176

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

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FINANCIAL SECTION

Independent Auditor's Report

*Mayor and Municipal Legislature
Municipality of Rincón
Rincón, Puerto Rico*

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Rincon, Puerto Rico, (the Municipality) as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As more fully described in Note G to the financial statements, the Municipality has not determined and recorded in governmental activities an estimate of the liability of the municipal solid waste landfill post closure care costs of a closed solid waste landfill. Accounting principles generally accepted in the United States of America requires that the liability of post closure care costs be accounted, which would increase liabilities and decrease net assets of governmental activities. The amount by which this departure would affect the liabilities of the governmental activities is not reasonably determinable.

We were unable to obtain sufficient and competent evidence to support the allocation of pool cash recorded as restricted cash and cash equivalents in the Commonwealth Legislative Grants Fund because of the inadequacy of accounting records and reports, which do not permit the application of adequate alternative procedures.

In our opinion, except for the effects, if any, of not determining and recording the estimate of solid waste landfill post closure care costs of a closed solid waste landfill in governmental activities, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities of the Municipality of Rincon, Puerto Rico as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient and competent evidence to support the allocation of pool cash recorded as restricted cash and cash equivalents in the Commonwealth Legislative Grants Fund, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the Commonwealth Legislative Grants Fund of the Municipality of Rincon, Puerto Rico as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the General Fund, Economic Development Administration Grant Fund, the Debt Service Fund, the \$1,660,000 Bond Issuance Fund, the Community Development Grant Fund, the Law No. 52 Fund and the aggregate remaining fund information of the Municipality of Rincon, Puerto Rico as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 26, 2005 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 4 through 10 and the Budgetary Comparison Schedule – General Fund on page 44 are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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



Rodriguez, Rivera & Torres LLP

MUNICIPALITY OF RINCON, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004

Our discussion and analysis of the Municipality of Rincón financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the financial statements, which begin on page 10.

FINANCIAL HIGHLIGHTS

- The asset of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2004 by \$17,423,635 (net assets), of which \$16,386,983 were invested in capital assets (net of accumulated depreciation, and related debt) and \$4,458,450 were restricted. The unrestricted fund balance has a negative balance of \$3,421,800.
- The Municipality's total net assets increased by \$4,360,085 from previous year restated balance.
- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$4,547,809, an increase of \$365,330 in comparison with the prior year.
- The General Fund, on a current financial resources basis, reported deficiency of revenues, and other financing sources over expenditures and other financing uses of (\$6,606), after revenues from property tax amnesty of \$196,555, and an unreserved negative fund balance of (\$464,600).
- On a budgetary basis, actual revenues exceeded actual expenditures by \$236,048.
- Long term debt decreased by \$42,980 approximately 1 percent with respect to prior year.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 11 through 12) provide information about the activities of the Municipality as a whole and present a long-term view of the Municipality's finances. Fund financial statements start on page 13. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements report the Municipalities' operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds.

Reporting the Municipality as a Whole

The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Municipality's *net assets* and changes in them. You can think of the Municipality's net assets, the difference between assets and liabilities, as one way to measure the Municipality's financial health, or *financial position*. Over time, *increases or decreases* in the Municipality's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the Municipality's property tax base and the condition of the roads, to assess the *overall health* of the Municipality of Rincón.

In the Statement of Net Assets and the Statement of Activities, we showed the Municipality activities:

MUNICIPALITY OF RINCON, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004

- Governmental activities – Most of the Municipality's basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, state and federal grants finance most of these activities.

Reporting the Municipality's Most Significant Funds

Fund Financial Statements

Our analysis of the Municipality's major funds begins on page 8. The Fund financial statements begin on page 13 and provide detailed information about the most significant funds, not the Municipality as a whole. Some funds are required to be established by bond covenants.

The Municipality's basic services are reported in the governmental funds, that uses an accounting approach which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Municipality's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation on pages 14 and 16 of this report.

THE MUNICIPALITY AS A WHOLE

During the year the Municipality performed an evaluation of the amount reported as capital asset for the year ended June 30, 2003. As result of the evaluation the Municipality management supported evidence to increase the balance of the capital assets account shown in the financial statement of prior year.

Also the management performed adjusting entries to the accounting records which also affect the ending fund balance as of June 30, 2003.

The ending balance shown as net assets at the end of the June 30, 2003 was \$8,533,502. After recording the adjustment to the accounting records this ending net asset balance (current year's beginning as restated) increased to \$13,063,550.

The changes in net assets during the year ended June 30, 2004 was \$4,360,085.

Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 3) of the Municipality's governmental activities.

MUNICIPALITY OF RINCON, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004

Table 1

Net Assets

Governmental Activities

	2004	2003 as restated	Change	%
Current and other assets	\$ 7,232,346	\$ 5,751,083	\$ 1,481,263	26%
Capital assets	18,700,962	14,956,742	3,744,220	25%
Total Assets	\$ 25,933,308	\$ 20,707,825	\$ 5,225,483	25%
Other liabilities	\$ 1,981,286	\$ 1,072,907	908,379	85%
Long term debt outstanding	6,528,387	6,571,368	(42,981)	-1%
Total liabilities	\$ 8,509,673	\$ 7,644,275	865,398	11%
Net Assets				
Investment in Capital Assets, net of related debt	\$ 16,386,983	\$ 13,786,572	\$ 2,600,411	19%
Restricted for:				
Debt services	483,966	96,265	387,701	403%
Capital projects	3,293,120	2,127,222	1,165,898	55%
Other specified purposes	681,364	1,038,181	(356,817)	-34%
Unrestricted	(3,421,800)	(3,984,690)	562,890	14%
Total net assets	\$ 17,423,635	\$ 13,063,550	\$ 4,360,083	33%

Governmental Activities

Revenues for the Municipality's governmental activities increase by 24% (\$2,653,985) while total expenses increased by 16% (\$1,472,346). The increase in revenues was due primary to a positive change of \$2,496,951 or 102% in capital grants and contributions. The expenses related to welfare increased by \$1,610,162 mostly due to an increase in federal programs grants.

The following table summarizes the changes in net assets for the fiscal years ended 2004 and 2003

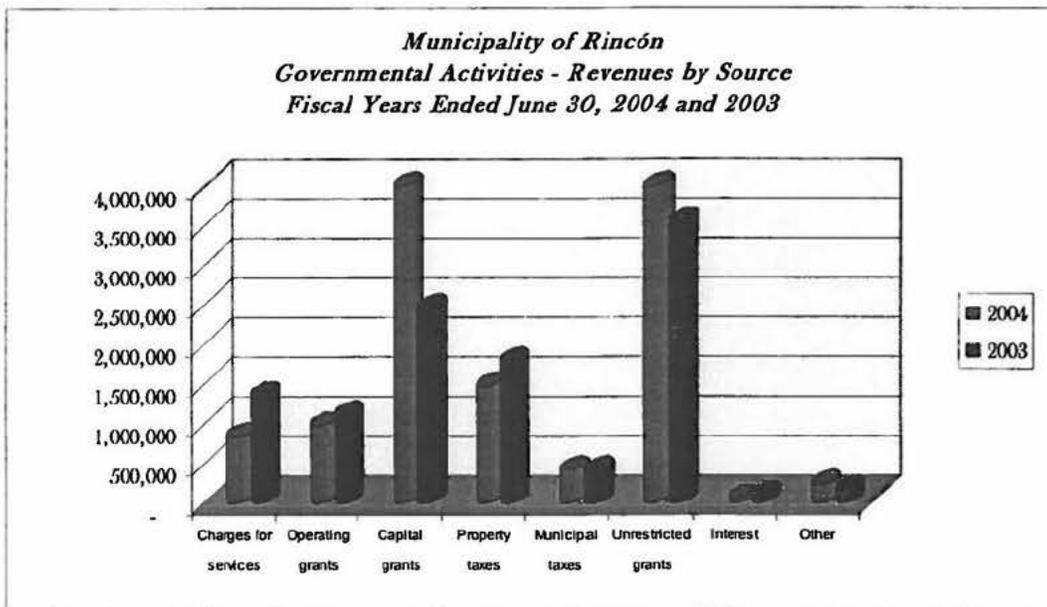
Table 2
Changes in Net Assets
Governmental Activities

	2004	% of Total	2003 as restated	Change	% of Change
Revenues:					
Program revenues:					
Charges for services	\$ 817,050	6%	\$ 1,338,368	(521,318)	-39%
Operating grants and contributions	963,872	7%	1,098,261	(134,389)	-12%
Capital grants and contributions	4,950,916	37%	2,453,965	2,496,951	102%
General revenues:				-	
Property taxes	1,457,846	11%	1,770,982	(313,136)	-18%
Municipal taxes	410,613	3%	400,253	10,360	3%
Other grants and contributions	4,633,049	35%	3,539,385	1,093,664	30%
Interest	36,342	0%	88,121	(51,779)	-59%
Other	223,055	1%	149,424	73,631	49%
Total revenues	\$ 13,492,744	100%	10,838,759	2,653,985	24%

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004

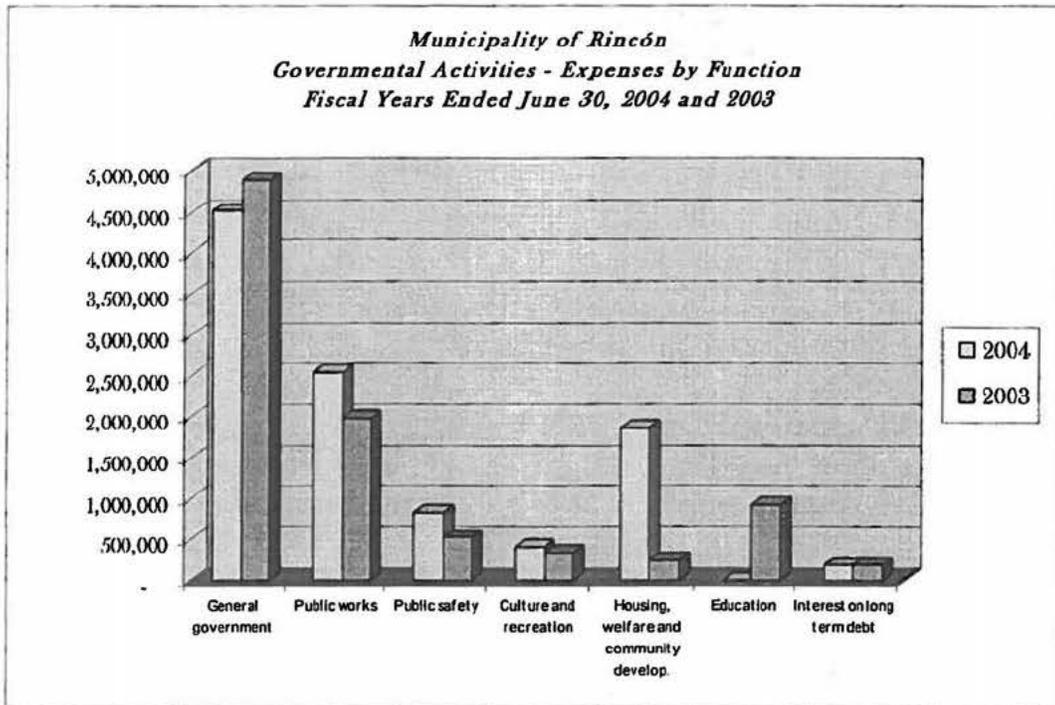
Expenses:

General government	4,519,444	43%	4,903,668	(384,224)	-8%
Public Safety	826,520	8%	526,027	300,493	57%
Public Works	2,798,143	25%	1,992,514	805,629	40%
Welfare	1,862,555	18%	252,393	1,610,162	638%
Culture and recreation	416,780	4%	355,153	61,627	17%
Education	5,416	0%	924,183	(918,767)	-99%
Interest on long-term debt	186,593	2%	189,168	(2,575)	-1%
Total expenses	10,615,452	100%	9,143,106	1,472,346	16%
Increase(decrease) in net assets	2,877,292		1,695,653	1,181,639	70%
Special items					
Property tax amnesty	251,830		-	251,830	-
Transfer of land and recreational facilities	1,230,963		-	1,230,963	-
Increase in net assets	4,360,085		1,695,653	2,664,432	157%
Net assets at beginning of year					
as restated	13,063,550		11,367,897	1,695,653	15%
Net assets end of year	\$ 17,423,635		\$ 13,063,550	\$ 4,360,085	33%



Approximately 35% of the Municipality's revenues came from grants and contributions not restricted to specific programs, 44% from operating and capital grants and 11% from property taxes. Revenues (not including special items) increased by 24% in comparison with year 2003. The most significant change, considering its participation in total revenues, is a 30% increase grants and contributions not restricted to specific programs.

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004



The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 43%, public works and sanitation with 25% and welfare with 18%. Program revenues of the Municipality covered 60% of total expenses.

Expenses increased 16% in comparison with previous year. This includes a net difference of an increase in housing, welfare and community development due to additional costs related primarily to federal grants; a 57% increase in public safety (due to the payment of extra hours and bonus to municipal police) and a 40% increase in public works and sanitation (due to additional capital assets maintenance and other noncapitalizable costs). Changes in net assets in 2004 include additional resources from property tax amnesty in the amount of \$251,830 which was reported as a special item in the financial statements.

As noted previously the increase in revenues combined with an increase in expenses caused the net change in net assets to increase approximately 157% compared with net change in net assets reported in 2003 statement of activities.

THE MUNICIPALITY'S FUNDS

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2004, the governmental funds reported combined ending fund balances of \$4,547,809 a net increase of \$365,335 in comparison with the prior year. This increase was caused primarily by a net change in Commonwealth Legislature Resolution Fund of \$1,448,105 and \$222,927 in Other Governmental Funds. Of total combined fund balances, \$(960,543) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents 22% of total combined ending fund balance. For the year ended June 30, 2004, the fund balance of the general fund decreased by \$6,606. The key factor of this change is a net decrease of \$361,413 in other special funds with self imposed restrictions included as part of the general fund. Resources to finance these special funds were provided in previous years but funds were expended in current year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Investment in capital assets for governmental activities as of June 30, 2004, amounted to \$16,386,983 millions (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, park facilities, roads, bridges and construction in progress.

Capital assets as of June 30, 2004 and 2003 follow:

Table 4
Capital Assets, net
As of June 30,

	Governmental Activities	
	2004	2003 (as restated)
Non-depreciable assets:		
Land and improvements	\$ 3,104,358	\$ 2,060,618
Construction in progress	2,953,381	1,961,902
Depreciable assets:		
Buildings and improvements	7,604,421	5,576,554
Vehicules, machinery and equipment	2,387,084	2,546,431
Infrastructures	2,651,718	2,811,237
Total	\$ 18,700,962	\$ 14,956,742

Significant capital projects underway in construction in progress included the following:

Improvements to Recreational Square	\$ 937,233
Improvements to City Hall	\$ 1,477,228
Barrero Sewer System	\$ 341,722
Infrastructure improvements	\$ 197,196

This year's major capital assets additions (approximately) included:

- \$1,230,963 of land and property donated by the Puerto Rico Department of Recreation and Sports.
- \$1,229,150 Sunset Enterprises Village.

More detailed information about the Municipality's capital assets and future projects is presented in Note E to the financial statements.

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004

Debt

Debt Administration

Long term debt as of June 30, 2004 and 2003 follows:

	Outstanding Long-term Debt	
	Fiscal years ended June 30,	
	Governmental Activities	
	2004	2003 (as restated)
Bonds and notes payable	\$ 3,899,000	\$ 4,261,000
Compensated absences	702,654	581,873
Claims and judgments	-	246,173
Bond anticipation note	530,000	-
Payable to CRIM –delinquent accounts	142,472	165,479
Christmas Bonus Payable	181,764	167,418
PR Dept of Labor–Unemployment payment plan	329,186	464,188
CRIM-property tax 6/30/99 and 6/30/00 (Ley 42)	464,571	470,663
CRIM- property tax advances current year	88,520	-
P.R. Department of Treasury-6/30/93 property tax	51,749	61,765
LIMS debt	138,471	152,749
Total	\$ 6,528,387	\$ 6,571,308

At the end of the current fiscal year, the Municipality had a total bonded debt and notes payable outstanding of \$3,899,000. Other obligations include a \$530,000 bond anticipation loan, accrued Christmas bonus, compensated absences and vacation and sick days, and a debt to the Municipal Revenue Collection Center (CRIM). Compensated absences and vacations are paid when due.

More detailed information about the Municipality's long term liabilities is presented in Note F to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2004-2005 budget. The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2005 are \$ 6,791,292 an increase of approximately 6% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. The construction industry has been one of the major sources of income generated by the Municipality, in the construction of personal housing, contributing with construction.

CONTACTING FINANCE DIRECTOR

This financial report is design to provide our citizens, taxpayers and customers and creditors with a general overview of the Municipality finances and to show accountability for the money it receives. If you have any questions about this report or need any additional information contact the Finance Department at the Municipality of Rincon, PO Box 97, Rincón, P.R. 00677.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**STATEMENT OF NET ASSETS
JUNE 30, 2004**

	Governmental Activities
ASSETS	
Cash and cash equivalents	\$ 946,920
Due from:	
Commonwealth Governmental entities (note C)	791,819
Federal Government (note C)	645,978
Restricted assets:	
Cash and cash equivalents	3,571,261
Cash with fiscal agent	1,276,368
Capital Assets (note E):	
Nondepreciable assets:	
Land and construction in progress	6,057,738
Depreciable assets	
Buildings, infrastructure, equipment and other	12,643,223
Total capital assets, net	18,700,962
Total assets	\$ 25,933,308
LIABILITIES	
Accounts payable	\$ 1,442,559
Accrued payroll taxes and withholdings	42,646
Due to:	
Commonwealth Governmental entities (note C)	43,664
Accrued interest payable	60,862
Deposits payable	5,300
Deferred revenues:	
Municipal License taxes	330,057
Intergovernmental-Commonwealth agencies	33,606
Federal grants	22,592
Long term liabilities (note F):	
Due within one year	826,683
Due in more than one year	5,701,704
Total liabilities	8,509,673
NET ASSETS	
Invested in capital assets, net of related debt	16,386,983
Restricted for:	
Debt service	483,966
Capital Projects	3,293,120
Other specified purposes	681,364
Unrestricted (deficit)	(3,421,800)
Total net assets	\$ 17,423,635

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2004**

<u>Functions</u>	<u>Program Revenues</u>			<u>Net (expense) revenue and changes in net assets</u>	
	<u>Expenses</u>	<u>Fees, Fines and Charges for services</u>	<u>Operating Grants and Contributions</u>		<u>Capital Grants and Contributions</u>
Governmental Activities:					
General government	\$ 4,519,444	\$ 817,050	\$ 494,258	\$ -	\$ (3,208,136)
Public works and sanitation	2,798,143	-	-	3,081,771	283,628
Public safety	826,520	-	81,715	-	(744,805)
Culture and recreation	416,780	-	1,394	-	(415,386)
Education	5,416	-	-	-	(5,416)
Welfare and community development	1,862,555	-	386,506	1,869,145	393,096
Interest on long term debt	186,593	-	-	-	(186,593)
Total	<u>\$10,615,452</u>	<u>\$ 817,050</u>	<u>\$ 963,872</u>	<u>\$ 4,950,916</u>	<u>(3,883,613)</u>

General revenues :

Property taxes	1,457,846
Municipal licenses taxes	410,613
Grants contributions not restricted to specific programs	4,633,049
Interests	36,342
Rent	49,390
Other	173,665

Special items (note P) :

Property taxes-amnesty	251,830
Transfer of land and recreational facilities	1,230,963
Total general revenues and special items:	<u>8,243,698</u>

Change in net assets	4,360,085
Net assets-beginning, as restated (note K)	13,063,550
Net assets-ending	<u>\$ 17,423,635</u>

The accompanying notes are an integral part of these statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2004

	General Fund	Commonwealth Legislative Resolutions	Economic Development Administration Grant	Debt Service	\$1,660,000 Bond Issuance	Community Development Block Grant Program	Law no. 52	Other Governmental Funds	Total Governmental Funds
ASSETS									
Cash and cash equivalents	\$ 543,272	\$ -	\$ 184,328	\$ -	\$ -	\$ 3,190	\$ -	\$ 216,130	\$ 946,920
Due from:									
Commonwealth Governmental entities	104,493	-	-	27,833	-	-	329,500	239,111	700,937
Federal Government	-	-	132,079	-	-	471,820	-	42,078	645,978
Other funds	840,531	-	-	-	-	-	-	42,832	883,362
Advances to other funds	-	694,758	-	-	-	-	-	5,010	699,768
Restricted assets:									
Cash and cash equivalents	17,859	3,199,796	-	-	-	-	-	353,606	3,571,261
Cash with fiscal agent	9,559	-	-	503,707	763,103	-	-	-	1,276,368
Total assets	\$ 1,515,713	\$ 3,894,554	\$ 316,407	\$ 531,540	\$ 763,103	\$ 475,010	\$ 329,500	\$ 898,767	\$ 8,724,593
LIABILITIES									
Accounts payable	\$ 318,998	\$ -	\$ 147,948	\$ -	\$ 179,580	\$ 391,364	\$ -	\$ 404,671	\$ 1,442,559
Accrued payroll taxes and withholdings	42,646	-	-	-	-	-	-	-	42,646
Matured bonds and notes payable	-	-	-	275,000	-	-	-	-	275,000
Matured interests payable	-	-	-	47,574	-	-	-	-	47,574
Due to:									
Commonwealth Governmental entities	43,664	-	-	-	-	-	-	-	43,664
Other funds	-	-	168,437	-	-	83,646	495,944	135,336	883,362
Advances from other funds	699,768	-	-	-	-	-	-	-	699,768
Deposits payable	5,300	-	-	-	-	-	-	-	5,300
Deferred revenues:									
Municipal License taxes	330,057	-	-	-	-	-	-	-	330,057
Intergovernmental-Commonwealth entities	-	-	-	-	-	-	329,500	54,762	384,262
Federal grants	-	-	-	-	-	-	-	22,592	22,592
Total liabilities	1,440,433	-	316,385	322,574	179,580	475,010	825,444	617,360	4,176,784
FUND BALANCES									
Reserved for:									
Encumbrances	21,982	-	-	-	-	-	-	-	21,982
Debt Service	-	-	-	208,966	-	-	-	-	208,966
Capital projects	-	3,199,796	22	-	583,523	-	-	278,672	4,062,013
Other specified purposes	517,898	-	-	-	-	-	-	2,735	520,633
Advances	-	694,758	-	-	-	-	-	-	694,758
Unreserved	(464,600)	-	-	-	-	-	(495,944)	-	(960,543)
Total fund balances	75,280	3,894,554	22	208,966	583,523	-	(495,944)	281,407	4,547,809
Total liabilities and fund balances	\$ 1,515,713	\$ 3,894,554	\$ 316,407	\$ 531,540	\$ 763,103	\$ 475,010	\$ 329,500	\$ 898,767	\$ 8,724,593

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2004**

Total fund balances- governmental funds	\$	4,547,809
<p>Amounts reported for governmental activities in the statement of net assets are different because:</p>		
<p>Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:</p>		18,700,962
<p>Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:</p>		
Christmas bonus reimbursement receivable		90,882
Law No. 52 funds receivable		329,500
Others		21,156
<p>Interest liabilities are not due and payable in the current period period and therefore, are not reported in the funds:</p>		(13,286)
<p>Some liabilities, including bonds payable, are not due and payable in current period and therefore are not reported in the funds:</p>		(6,253,388)
Net assets of governmental activities:	\$	<u>17,423,635</u>

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2004**

	General Fund	Commonwealth Legislative Resolutions	Economic Development Administration Grant	Debt Service	\$1,660,000 Bond Issuance	Community Development Block Grant Program	Law No. 52	Other Governmental Funds	Total Governmental Funds
REVENUES									
Property taxes (note H)	\$ 977,875	\$ -	\$ -	\$ 479,971	\$ -	\$ -	\$ -	\$ -	\$ 1,457,846
Municipal license taxes (note I)	410,613	-	-	-	-	-	-	-	410,613
Intergovernmental: (note J)									
Commonwealth entities	4,698,940	2,030,142	-	-	-	-	164,750	473,920	7,367,752
Federal grants	-	-	665,452	-	-	1,869,145	-	378,044	2,912,641
Licenses, permits and other local taxes	651,935	-	-	-	-	-	-	-	651,935
Fees, fines and charges for services	165,115	-	-	-	-	-	-	-	165,115
Interest	33,470	-	-	2,872	-	-	-	-	36,342
Rent	49,390	-	-	-	-	-	-	-	49,390
Other	169,830	3,835	-	-	-	-	-	-	173,665
Total revenues	7,157,167	2,033,977	665,452	482,843	-	1,869,145	164,750	851,965	13,225,299
EXPENDITURES									
Current:									
General government	4,016,098	-	-	-	-	-	671,090	3,368	4,690,555
Public works and sanitation	1,880,922	14,999	-	-	-	201,000	-	251,123	2,318,044
Public Safety	628,176	-	-	-	-	-	-	83,153	711,329
Culture and recreation	271,996	-	-	-	-	-	-	1,394	273,390
Welfare and community development	-	44,483	-	-	-	1,369,437	-	403,920	1,617,840
Claims and judgments	141,441	-	-	-	-	-	-	-	141,441
Capital outlays	257,377	526,390	831,867	-	822,066	298,708	-	343,447	3,079,856
Debt Service									
Principal	90,000	-	-	302,000	-	-	-	-	392,000
Interest	66,500	-	-	120,839	-	-	-	-	187,339
Total expenditures	7,352,510	585,872	831,867	422,839	822,066	1,869,145	671,090	1,088,405	13,641,794
Excess (deficiency) of revenues over expenditures	(195,343)	1,448,105	(166,415)	60,004	(822,066)	-	(506,340)	(234,441)	(416,495)
Other financing sources (uses)									
Proceeds from bond anticipation notes	-	-	-	-	-	-	-	530,000	530,000
Transfers in	2,578	-	72,833	-	-	-	10,396	-	85,607
Transfers out	(10,396)	-	-	(2,578)	-	-	-	(72,633)	(85,607)
Total other financing resources (uses)	(7,818)	-	72,633	(2,578)	-	-	10,396	457,367	530,000
Special items (note P)									
Property taxes - amnesty	196,555	-	-	55,275	-	-	-	-	251,830
Total special items	196,555	-	-	55,275	-	-	-	-	251,830
Net change in fund balance	(6,606)	1,448,105	(93,782)	112,701	(822,066)	-	(495,944)	222,925	365,335
Fund balance at beginning of year, as restated (note K)	81,886	2,446,449	93,804	96,265	1,405,589	-	-	58,482	4,182,474
Fund balance at end of year	\$ 75,280	\$ 3,894,554	\$ 22	\$ 208,966	\$ 583,523	\$ -	\$ (495,944)	\$ 281,407	\$ 4,547,809

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2004**

Net change in fund balances - total governmental funds: \$ 365,335

Amounts reported for governmental activities in the Statement of activities are different because:

Governmental funds reports capital assets outlays as expenditures.

However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

Expenditures for capital assets	\$ 3,079,856		
Less: current year depreciation	<u>(698,474)</u>	\$	2,381,382

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:

(30,316)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Christmas bonus reimbursement	\$ 90,882		
Law No. 52 funds receivable	329,500		
Donated capital assets	1,400,740		
Others	<u>21,156</u>	\$	1,842,277

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

Puerto Rico Electric Power Authority (PREPA)-prior year	\$ (62,962)		
CRIM-prior year	(131,528)		
CRIM-current year	(71,612)		
Christmas bonus reimbursement-prior year	<u>(77,768)</u>	\$	(343,870)

Proceeds from bond anticipation notes is an other financing source in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:

(530,000)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments (net change)			30,000
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Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

General obligation bonds and notes	\$ 362,000		
Other long term liabilities	<u>655,715</u>	\$	1,017,715

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:

Compensated absences	\$ (149,478)		
Unemployment debt	(25,032)		
Accrued interest (net change)	746		
Christmas bonus	(181,764)		
Others	<u>(16,910)</u>	\$	(372,438)

Change in net assets of governmental activities: \$ 4,360,085

The accompanying notes are an integral part of these statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Rincon was founded in 1770. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of twelve (12) members of the Municipal Legislature. The Municipality engages in comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

1. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality of Rincon (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and,
 - 1) The primary government can impose its will on the potential component unit and/or,
 - 2) A financial benefit/ burden exist between the primary government and the potential component unit.

There are two methods of presentation of the component unit in the financial statement:

- a. Blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances.
- b. Discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

In fiscal year 2003-2004 the Municipality adopted Statement No. 39 "*Determining Whether Certain Organizations Are Component Units - an amendment of GASB 34 Statement No. 14*". This Statement amends GASB Statement No. 14 to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. A legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if *all* of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an *individual organization* that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

In addition, other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government.

The Statement continues the requirement in Statement No. 14 to apply professional judgment in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

Basis of presentation, measurement focus and basis of accounting

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Government-wide statements

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenditures or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users.

The Municipality reports the following major governmental funds:

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

Commonwealth Legislature Grants Fund: This fund accounts for revenue sources from grants provided by the Commonwealth's Legislature for specific purposes which include, among others, acquisition, development and improvements of capital assets.

Debt Service Fund: This fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Economic Development Administration Grant Fund: Economic Development Administration Grant Fund is used to account for the financial resources used for the construction of a capital asset.

\$1,660,000 Bond Issuance Fund: This fund is used for improvement and construction of Municipality's new city hall.

Law No. 52 Fund: This fund is used to account for payroll costs reimbursements by the Puerto Rico Department of Labor.

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets. The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when the related liability is incurred.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred, subject to the availability criteria. Revenues on intergovernmental grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met and revenue becomes available. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available.

The Municipality reports deferred revenues in the governmental funds statements which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met. (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following: 1) payments of principal and interest on general long term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) 2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Notes to Financial Statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

Required Supplementary Information

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

2. Cash, cash equivalents (unrestricted and restricted) and restricted cash with fiscal agents

Cash and cash equivalents consists of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth Legislature Resolutions is restricted since their use is limited as required by law.

Restricted cash with fiscal agent in the debt service fund consist of the undisbursed balance of property tax collections retained by the Commonwealth of Puerto Rico, which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent in the \$1,660,000 Bond Issuance fund represents the undisbursed proceeds from the \$1,660,000 bond which is maintained in a cash custodian account by the Governmental Development Bank of Puerto Rico (GDB). Restricted cash and cash equivalents of other governmental funds represent the undisbursed balance of bond anticipation notes held in custody of Rural Development.

3. Receivables and due from governmental entities

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of subsequent fiscal year.

4. Interfund receivables and payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to 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 from/to other funds".

5. Inventories

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

6. Capital assets

Capital assets of the primary government, with include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items) are reported in the governmental activities in the Statements of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The Municipality maintains a threshold level of \$1 or more for capitalizing vehicles, machinery and equipment. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

All capital assets, other than land, are depreciated using the straight-line method over the following useful lives:

<u>Description</u>	<u>Years</u>
Land improvements	20
Buildings and building improvements	20-50
Infrastructure	20-40
Vehicles, machinery and equipment	5-15

7. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

8. Deferred bond issuance costs

Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

9. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

10. Fund balances and Net Assets

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- | | |
|---------------------------|---|
| Encumbrances: | Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received. |
| Debt Service: | Represents net assets available to finance future debt service payments. |
| Capital Projects: | Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed. |
| Other specified purposes: | Represent amounts to be used for future expenditures of Federal and Commonwealth's grants as well as funds reserved through enabling legislation passed by the government itself, to be used to finance activities other than construction or capital improvement commitments |
| Advances: | Represent the non current portion of interfund loans. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

In the government-wide statements net assets are segregated into three categories:

- Invested in capital assets, net of related debt: Consists of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
- Restricted net assets: Represents net assets (restricted assets net of related debt) that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
- Unrestricted net assets: Represent net assets that do not meet the definition of net assets Invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

11. Interfund transactions

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

12. Risk financing

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Rincon consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

13. Use of estimates

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

14. Future adoption of accounting pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

Statement	To be Adopted in Fiscal year ended,
40 Deposit and Investment Risk Disclosure - an amendment of GASB Statement No. 3	June 30, 2005
42 Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	June 30, 2006
43 Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans	June 30, 2008
44 Economic Condition Reporting: The Statistical Section - an amendment of NCGA Statement No. 1	June 30, 2006
45 Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions	June 30, 2010
46 Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34	June 30, 2007

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
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NOTE B- DEPOSITS

The Municipality maintains its cash deposits in commercial banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. The table presented below discloses the level of custody risk assumed by the Municipality based upon how its deposits were insured or secured with collateral at June 30, 2004:

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

The bank balances and carrying amount of deposits with financial institutions as of June 30, 2004 were as follows:

	Category			Bank balance	Carrying amount
	1	2	3		
Deposits in commercial banks	\$4,690,208	\$ -	\$ -	\$4,690,208	\$ 4,518,181
Deposits in Governmental banks	-	-	1,276,369	1,276,369	1,276,369
	<u>\$4,690,208</u>	<u>\$ -</u>	<u>\$1,276,369</u>	<u>\$5,966,577</u>	<u>\$ 5,794,550</u>

Reconciliation to government-wide statement of net assets:

	Unrestricted	Restricted	Total
Carrying amount of deposits in commercial banks	\$ 946,920	\$ 3,571,261	\$ 4,518,181
Carrying amount of deposits in governmental banks	-	1,276,369	1,276,369
	<u>\$ 946,920</u>	<u>\$ 4,847,630</u>	<u>\$ 5,794,550</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
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NOTE C- DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2004 follows:

	Commonwealth Entities	Federal Government
Puerto Rico Department of Education	\$ 42,000	\$ -
Municipal Revenue Collection Center (CRIM)- property taxes amnesty (general fund)	62,493	
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	27,833	-
Puerto Rico Department of Treasury – Christmas Bonus Reimbursement	90,882	
Rural Development Corporation	182,358	
Office of Commissioner of Municipal Affairs - CDBG	-	471,820
Economic Development Administration-EDA	-	132,079
Public Order Code	23,369	-
Puerto Rico Department of Labor – Law No.52	329,500	
Office of Elderly Affairs	31,057	
Puerto Rico Department of Family – Child Care		42,079
Others	2,327	-
	<u>\$ 791,819</u>	<u>\$ 645,978</u>

The amounts due from Puerto Rico Department of Labor (\$329,500) and \$21,156 of Office of elderly Affairs are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards.

2. Amounts due to governmental entities as of June 30, 2004 follows:

	Commonwealth Entities
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 3,770
Puerto Rico Retirement Plan Administration	32,992
Puerto Rico General Services Administration	6,902
	<u>\$ 43,664</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
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NOTE D- INTERFUND TRANSACTIONS

1. Due from/to other funds

Amounts due from to other funds represent advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Major Fund - EDA	\$ 125,605
	Major Fund - CDBG	83,646
	Major Fund – Law No. 52	495,944
	Other governmental funds – Child Care	86,043
	Other governmental funds-others	49,303
Other governmental fund - Citizens Participation Fund	Major Fund - EDA	<u>42,822</u>
Total:		<u>\$ 883,363</u>

2. Advances to other funds

Advances to other funds by the Commonwealth Legislative Grants Fund and Other Governmental Funds in the amount of \$ 699,768 represents loans to the general fund for payments of payrolls, payroll taxes and other operational expenditures in previous periods not reimbursed as of fiscal year-end.

3. Operating transfers

The \$85,607 transfers among individual funds were made for the following: (1) interest earned on cash with fiscal agents in the debt service fund which is transferred to the general fund; (2) transfers from general fund to Law No. 52 Fund to cover costs not to be reimbursed by the Puerto Rico Department of Labor and, (3) transfers between Citizens Participation Fund (included as other governmental funds) and Economic Development Administration Fund for matching purposes.

COMMONWEALTH OF PUERTO RICO
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NOTE E- CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2004 is as follows:

	Balance July 1, 2003, as restated	Increases	Decreases	Balance June 30, 2004
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 2,060,618	\$ 1,043,739	\$ -	\$ 3,104,358
Construction in progress	1,961,902	2,594,479	1,603,000	2,953,380
Total capital assets not being depreciated:	4,022,520	3,638,218	1,603,000	6,057,738
Capital assets, being depreciated:				
Buildings and building improvements	7,910,030	2,180,414	-	10,090,445
Infrastructure	5,153,495	-	-	5,153,495
Vehicles, machinery and equipment	4,845,466	257,377	175,310	4,927,533
Total capital assets being depreciated	17,908,991	2,437,792	175,310	20,171,472
Less accumulated depreciation for:				
Buildings and building improvements	2,333,476	152,548	-	2,486,024
Infrastructure	2,342,258	159,518	-	2,501,776
Vehicles, machinery and equipment	2,299,035	386,409	144,994	2,540,449
Total accumulated depreciation	6,974,769	698,474	144,994	7,528,249
Total capital assets being depreciated, net	10,934,222	1,739,318	30,316	12,643,223
Governmental activities capital assets, net	\$ 14,956,742	\$ 5,377,536	\$ 1,633,316	\$ 18,700,962

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

Governmental activities:

General government	\$ 37,371
Public works and sanitation	239,220
Public safety	80,456
Culture and recreation	143,166
Welfare and community development	36,320
Education	2,423
Infrastructure	159,518
Total depreciation expense, governmental activities	\$ 698,474

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
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NOTE E- CAPITAL ASSETS - Continued

On September 25, 2001 the US Department of Commerce, Economic Development Administration (EDA) approved a \$1,000,000 grant to the Municipality for the construction of a Waterfront Tourism Business Center Sunset Village in the Municipality. The receipt of such grant is conditioned upon compliance with terms and conditions of a grant agreement. As required by the grant agreement, for projects involving acquisition, construction, or improvement of a building, the Municipality should agree to declare and furnish to EDA, prior to initial award disbursement, a lien, covenant, or other statement, satisfactory to EDA in form and substance of EDA's interest in the property acquired or improved in whole or in part with funds made available under this award. On December 20, 2002 the Municipality signed a deed of a voluntary mortgage in the amount of \$1,000,000 in favor of EDA over a parcel of land on which the project is located. During a 20 year term, the Municipality shall not sell, lease, mortgage or otherwise use or alienate any right to, or interest in the grant property as prohibited by the grant agreement, or use that property for any other purposes than the purposes for which the project was financed by EDA unless prior approval of the Assistant Secretary of the Department is obtained. Upon violation of applicable restrictions, the total amount will become due and payable by the Municipality to EDA.

NOTE F- LONG TERM DEBT

1. Summary of long- term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2004:

	Balance at July 1, 2003, as restated	Increases	Decreases	Balance at June 30, 2004	Due within one year
General, Special Obligations Bonds and Notes	\$ 4,261,000	-	\$ 362,000	\$ 3,899,000	\$ 393,000
Bond anticipation note	-	530,000	-	530,000	-
Note payable to CRIM-Law No. 42	470,663	-	6,092	464,571	-
Note payable to CRIM-LIMS	152,749	-	14,277	138,471	15,140
Note payable to CRIM-financing of delinquent accounts	165,479	-	23,008	142,472	60,319
Payable to CRIM- final settlement 2003- 2004	-	88,520	-	88,520	-
Payable to Puerto Rico Treasury Department - prior years property taxes	61,765	-	10,016	51,749	10,015
Payable to Puerto Rico Department of Labor- unemployment tax	464,188	25,032	160,033	329,186	133,361
Compensated absences	581,873	149,478	28,697	702,654	33,084
Christmas Bonus	167,418	181,764	167,418	181,764	181,764
Judgments and legal claims	246,173	-	246,173	-	-
	<u>\$ 6,571,308</u>	<u>\$ 974,794</u>	<u>\$ 1,017,714</u>	<u>\$ 6,528,387</u>	<u>\$ 826,683</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2004 amount to \$3,899,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).

A detail of the general and special obligation bonds and notes as of June 30, 2004 follows:

	<u>Outstanding Amount</u>
2000 special obligation bonds of \$910,000 due in annual installments of \$75,000 to \$125,000 through July 1, 2010; bearing interest at rates ranging from 5.0% to 8.0% (5.00% at June 30, 2004)	\$ 700,000
2002 special obligation bond of \$635,000 due in annual installments of \$10,000 to \$50,000 through January 1, 2027; bearing interest at 6.5%	630,000
1996 general obligation bonds of \$75,000 due in annual installments of \$10,000 through July 1, 2005; bearing interest at rates ranging from 6.5% to 8.00% (5.00% at June 30, 2004)	20,000
2001 general obligations notes of \$465,000 due in annual installments of \$95,000 to \$105,000 through July 1, 2006; bearing interest at rates ranging from 2.8% to 3.21% (2.80% at June 30, 2004)	300,000
1999 general obligation notes of \$705,000 due in annual installments of \$140,000 through January 1, 2004; bearing interest at 2.8%	140,000
1994 public improvement bond of \$721,000 due in annual installments of \$27,000 to \$52,000 through January 1, 2017; bearing interest at 5.0%	504,000
2002 general obligation bond of \$1,660,000 due in annual installments of \$30,000 to \$130,000 through July 1, 2026; bearing interest at rates ranging from 2.8% to 5.6% (2.80% at June 30, 2004)	1,605,000
	<u>\$ 3,899,000</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

The debt services requirement to amortize general and special obligation bonds and notes as of June 30, 2004 follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 393,000	\$ 186,117
2006	270,000	186,616
2007	276,000	193,947
2008	188,000	180,356
2009	194,000	147,829
2010-2014	780,000	577,267
2015-2019	613,000	408,152
2020-2024	640,000	239,717
2025-2027	545,000	39,805
Totals	\$ 3,899,000	\$ 2,159,804

3. Other long-term liabilities

Bond anticipation note – During the fiscal year the Municipality issued a \$530,000 bond anticipation note (BAN) through the Governmental Development Bank of Puerto Rico (GDB) and payable to the US Department of Agriculture-Rural Development (RD), to finance the construction of a sanitary sewer system. This amount represents the Municipality's share of project cost, which will be financed with a \$ 1,586,730 grant from RD. The Municipality intends to refinance this BAN on a long term basis through a \$530,000 general obligation bond, approved by GDB on September 24, 2003. The general obligation bond will bear 4.25% interest and will be due 10 years after bond issuance.

Outstanding
Amount

\$ 530,000

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

Outstanding
Amount

Note payable to CRIM (Law No. 42) – Law No. 42 of January 26, 2000 (as amended by Law No. 146 of October 11, 2001 and Law No. 172 of August 11, 2002) was enacted to authorize the CRIM to obtain a special loan in the form of a line of credit from the Governmental Development Bank of Puerto Rico (GDB) to finance a debt the municipalities of Puerto Rico own to CRIM for excess property tax advances as of June 30, 2000. Principal and interest payments are financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Amounts are retained from advances of property tax and amounts of municipal equalization fund send to the Municipality by the CRIM. Law No.42 was amended by Law no. 146 to extend from 10 to 30 years the financing period and by Law No. 172 to extend the debt period to June 30, 2001. On November 26, 2002 the Municipality entered into the financing agreement with the CRIM for a total amount of \$476,395, bearing interest at 6.18% and due on July 1, 2032. Debt service requirements in future years are as follows:

464,571

June 30	Principal	Interest
2005	\$ 6,477	\$ 28,647
2006	6,882	28,260
2007	7,314	27,807
2008	7,774	27,548
2009	8,262	27,310
2010-2014	49,771	125,828
2015-2019	67,514	107,257
2020-2024	91,361	83,979
2025-2029	124,195	51,415
2030-2032	95,021	10,679
Totals	<u>\$ 464,571</u>	<u>\$ 518,730</u>

Note payable to CRIM (LIMS) - On November 28, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$172,655 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$11,578, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the CRIM. Debt service requirements in future years are as follows:

138,471

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

June 30	Principal	Interest	Outstanding Amount
2005	\$ 15,139	\$ 7,942	
2006	16,054	7,023	
2007	17,025	6,049	
2008	18,051	5,016	
2009	19,141	3,921	
2010-2014	53,061	4,565	
Totals	\$ 138,471	\$ 34,517	

Note payable to CRIM (Financing of delinquent accounts)– On March 27, 2002 the Municipality entered into a financing agreement with the CRIM in the amount of \$165,479 to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a nonrevolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next 25 years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first 5 years will be financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first 5 years any collection from those delinquent accounts will be credited to the loan principal. After the 5 year period the loan outstanding balance will be restructured for a 25 years period. Debt service requirements in future years are as follows:

142,471

June 30	Principal	Interest
2005	\$ 60,319	\$ 9,261
2006	-	4,910
2007	-	5,340
2008	-	5,340
2009	1,412	5,298
2010-2014	8,615	24,939
2015-2019	11,913	21,641
2020-2024	16,474	17,080
2025-2029	22,781	10,774
2030-2032	20,957	2,532
Totals	\$ 142,471	\$ 107,115

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
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NOTE F- LONG TERM DEBT – Continued

	<u>Outstanding Amount</u>
Payable to Puerto Rico Treasury Department, prior years property taxes - represent advances of property taxes paid in prior years to the Municipality in excess of actual property tax revenues. This amount is currently being repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the CRIM.	51,749
Payable to CRIM, final settlement 2003-2004 - represents the balance owed to CRIM at June 30, 2004 for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal year ended June 30, 2004 (see note H). This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the CRIM.	88,520
Payable to Puerto Rico Department of Labor (PRDL) – unemployment tax - represent a debt to PRDL for unemployment taxes paid by PRDL in behalf of the Municipality. Of this amount, \$133,361 is paid through a payment plan due on April 1, 2005 and financed with unrestricted funds. The remaining \$195,825 represents debt not under a payment plan. The Municipality intends to refinance this amount on a long term basis through a general obligation bond. The Municipality's Legislature is in process to enact a Municipal Ordinance to approve the refinancing agreement.	329,186
Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds	702,654
Christmas Bonus - represent the accrued portion corresponding to fiscal year 2003-2004 of the Christmas bonus to be paid in December 2004	181,764

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
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NOTE F- LONG TERM DEBT – Continued

4. Unused available line of credit

During fiscal year the Governmental Development Bank of Puerto Rico (GDB) approved a \$1,200,000 line of credit to the Municipality to complete the construction of the new city hall. Interest rates will be variable (LIBOR + 1.25% ranging from 5% to 12% annually) and payable each January 1 and July 1. Repayment will be made in three annual installments ending in fiscal year 2006-2007 and financed with a Commonwealth Legislature Grant (RC no. 1474 of November 9, 2003). There were no amounts outstanding under this line of credit as of June 30, 2004.

NOTE G – LANDFILL CLOSURE AND POST CLOSURE CARE COSTS OBLIGATION

The Municipality discontinued the operation and ceased to accept solid waste in its landfill. Commonwealth's and Federal laws and regulations require the Municipality to perform certain closure procedures and establish monitoring and maintenance procedures at the landfill site for thirty years after closure. The closure procedures were assumed and completed by the Municipality. The Municipality is required to provide post closure care after closure is completed. Total post closure care costs have not been determined and accounted as required by accounting principles generally accepted in the United States of America as of June 30, 2004.

NOTE H – PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st.

The tax rates in force as of June 30, 2004 are 8.53% for real property (of which 8.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.53% for personal property (of which 6.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.50% and 5.50%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.50% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE H – PROPERTY TAXES - Continued

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$ \$88,520 resulting from the final settlement for fiscal year 2003-2004. The total amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

NOTE I – MUNICIPAL LICENSE TAXES

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15.

During the fiscal year ended June 30, 2004, the tax rates were as follows:

Financial business – 1.50% of gross revenues

Other organizations - .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$ 330,057 is recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE J – INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal equalization fund and subsidy send by CRIM	\$ 3,696,405
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	818,209
Reimbursement from Commonwealth Government - Christmas Bonus expenditures	133,317
Other intergovernmental revenues	51,009
	<u>\$ 4,698,940</u>

NOTE K – FUND BALANCE RESTATEMENTS

1. Fund balances

Certain special funds with self imposed restrictions (with fund balances of \$277,540) and previously reported as special revenues and capital project funds, were reclassified to the general fund. In addition, the beginning fund balance of the General Fund and the Commonwealth Legislative Grants Fund has been restated to recognize corrections of accounting errors. The following schedule reconciles the fund balance at July 1, 2003 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments			Balance at beginning of year, as restated
	Balance at beginning of year, as previously reported	Fund reclassifications	Correction of errors	
General fund	\$ (261,508)	\$ 277,540	\$ 65,854	\$ 81,886
Commonwealth Legislative Resolutions	3,024,967	-	(578,518)	2,446,449
Economic Development Grant	93,804	-	-	93,804
Debt service	96,265	-	-	96,265
\$1,660,000 Bond Issuance	1,405,589	-	-	1,405,589
Community Development Block Grant	-	-	-	-
Law No. 52	-	-	-	-
Other governmental funds	10,078	(277,540)	325,944	58,482
Total	<u>\$ 4,369,195</u>	<u>\$ -</u>	<u>\$ (186,720)</u>	<u>\$ 4,182,474</u>

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
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NOTE K – FUND BALANCE RESTATEMENTS - Continued

2. Net assets

Net assets at beginning of year have been adjusted to reflect the following restatements:

	<u>Amount</u>
Net assets at beginning of year as previously reported:	\$ 8,533,502
Restatements:	
Net correction of errors - capital assets	5,161,850
Note payable to CRIM (LIMS) not recorded	(256,500)
Other correction of errors	(375,302)
Net assets at beginning of year as restated:	<u>\$ 13,063,550</u>

NOTE L – RETIREMENT PLAN

1. Plan description

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and non-occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. 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. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Law No. 305 of September 24, 1999 amended the Act. No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE L – RETIREMENT PLAN - continued

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subject to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions have not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.725% of gross salary.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

<u>Fiscal year ended:</u>	<u>Law No. 447</u>	<u>System 2000</u>
2004	<u>\$ 114,374</u>	<u>\$ 57,077</u>
2003	<u>\$ 114,509</u>	<u>\$ 53,814</u>
2002	<u>\$ 125,832</u>	<u>\$ 47,435</u>

NOTE M – COMMITMENTS

1. Construction

The Municipality has commitments at June 30, 2004 of approximately \$ 4,062,013 for design, construction, improvements or renovation of certain municipal facilities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE N – CONTINGENCIES

1. Federal and State Grants

Projects financed by the Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that would not be covered by insurance. However, it is the opinion of the Municipality and the legal counsel that based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

NOTE P – SPECIAL ITEMS

1. Property tax amnesty

Law No. 74 of March 1, 2004 approved by the Commonwealth's Legislature (as amended by Law No. 131 of June 1, 2004) granted to taxpayers (for the period March 1, 2004 to June 30, 2004) an amnesty for payment of real and personal property tax debts. As a result, the CRIM distributed to the Municipality \$ 251,830 on property tax collections as of June 30, 2004 of which \$196,555 were recorded in the general fund and \$ 55,275 recorded in the debt service fund. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of Municipality's management.

2. Transfer of recreational and sport facilities

During the fiscal year, the Puerto Rico Department of Recreation and Sports, a Commonwealth agency, transferred to the Municipality at no cost, the ownership of certain recreational and sports facilities (included related land), pursuant to Act No. 120 of August 17, 2001 of the Commonwealth's Legislature.

NOTE Q – FUND BALANCE DEFICIT

Law No. 52 fund disclosed a fund balance deficit of \$495,944 in the fund statements. Revenues of this fund are recorded when payrolls costs, paid in advance by the general fund, are submitted to the Puerto Rico Department of Labor (PRDL) for reimbursement. After complying with this requirement, the Municipality is eligible to recognize related revenue. The amount of \$329,500 is recognized as deferred revenue in the fund statements since amounts were billed to PRDL before June 30, 2004 but were received after applicable availability period. An additional amount of \$166,444 will be recognized as revenue in fiscal period 2004-2005 since was billed to PRDL after June 30, 2004.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE R – OPERATIONAL DEFICIT-GENERAL FUND

The statement of revenues, expenditures and changes in fund balances disclosed a negative net change in fund balance of \$6,606 in the general fund. This negative amount is due primarily by the net results of other special funds (with self imposed restrictions) included as part of the general fund. Resources to finance these special funds were provided in previous years but funds were expended in current year.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2004**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 1,223,312	\$ 1,664,302	\$ 1,664,302	\$ -
Municipal license tax	420,000	420,000	410,613	(9,387)
Intergovernmental	3,952,032	3,952,032	3,926,751	(25,281)
Licenses, permits and other local taxes	377,000	518,493	651,935	133,442
Fees, fines and charges for services	185,000	185,000	156,115	(28,885)
Interest	65,000	65,000	35,473	(29,527)
Rent	65,000	65,000	49,390	(15,610)
Other	120,000	143,525	169,830	26,305
Total revenues	<u>6,407,344</u>	<u>7,013,352</u>	<u>7,064,409</u>	<u>51,058</u>
EXPENDITURES:				
Current:				
General government	3,735,433	4,081,294	3,910,245	171,048
Public works and sanitation	1,651,733	1,885,253	1,883,693	1,560
Public safety	753,405	686,593	677,450	9,143
Culture and recreation	266,773	275,212	271,973	3,239
Total expenditures	<u>6,407,344</u>	<u>6,928,352</u>	<u>6,743,362</u>	<u>184,990</u>
Excess (deficiency) of revenues over (under) expenditures	-	85,000	321,048	236,048
Other financing sources (uses)				
Transfers out	-	(85,000)	(85,000)	-
Total other financing sources (uses)	<u>-</u>	<u>(85,000)</u>	<u>(85,000)</u>	<u>-</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 236,048</u>	<u>\$ 236,048</u>

The accompanying notes are an integral part of this required supplementary information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION –
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2004

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared. Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level. The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET TO GAAP RECONCILIATION

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

	<u>Amount</u>
Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ 236,048
Budget to GAAP differences:	
Entity differences:	
Non budgeted funds recorded as revenues for financial reporting:	185,071
Non budgeted funds recorded as expenditures for financial reporting:	(546,484)
Transfers out recorded for budgetary purposes:	74,604
Basis of accounting differences:	
Revenues recorded for financial reporting but not in budgetary basis:	139,821
Revenues recorded in budgetary basis but not for financial reporting:	(33,000)
Expenditures recorded for financial reporting but not in budgetary basis:	(84,648)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary basis:	21,982
Net change in fund balance(GAAP basis):	\$ (6,606)

SINGLE AUDIT SECTION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2004

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note C)	Federal Expenditures (note A)
<u>U.S. Department of Agriculture</u>			
Non major program:			
Passed through the P.R. Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	\$ 12,266
Major program:			
Direct program:			
Water and Waste Disposal Systems for Rural Communities	10.760	N/A	344,926
			<u>357,192</u>
<u>U.S. Department of Commerce</u>			
Major program:			
Direct program:			
Grants for Public Works and Economic Development	11.300	N/A	665,421
<u>U.S. Department of Housing and Urban Development</u>			
Major program:			
Passed through the Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - State's Program	14.228	AB - 53 FD - 53	1,869,145
Non major program:			
Direct program:			
Section 8 Housing Choice Vouchers	14.871	N/A	145,207
			<u>2,014,352</u>
<u>U.S. Department of Justice</u>			
Non major programs:			
Passed through the P.R. Department of Justice:			
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	99DBMU0072	17,994
Local Law Enforcement Block Grant	16.592	2000LBVX1085	153
			<u>18,147</u>
<u>Federal Emergency Management Agency</u>			
Non major program:			
Passed through the Puerto Rico Governor's Office - (Governor's (Governor's Authorized Representative-GAR):			
Public Assistance Grants	83.544	N/AV	17,535
<u>U.S. Department of Health and Human Services</u>			
Non major program:			
Passed through the P.R. Department of Family-Families and Children Administration:			
Child Care and Development Block Grant	93.575	2002-2003-094 2003-2004-039	189,814
Total Expenditures of Federal Awards			<u>\$ 3,262,461</u>

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2004

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations". Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - FEDERAL CFDA NUMBER

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

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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

NOTE D – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

Description	Economic Development Administration Grant	Community Development Block Grant Program	Other Governmental Funds
10.558	\$ -	\$ -	\$ 12,266
10.760	-	-	344,926
11.300	665,421	-	-
14.228	-	1,869,145	-
14.871	-	-	145,207
16.580	-	-	17,994
16.592	-	-	153
83.544	-	-	17,535
93.575	-	-	189,814
Total federal awards expenditures:	<u>665,421</u>	<u>1,869,145</u>	<u>727,895</u>
Total non-federal awards expenditures:	<u>166,446</u>	<u>-</u>	<u>358,510</u>
Total expenditures, fund statements:	<u>\$ 831,867</u>	<u>\$ 1,869,145</u>	<u>\$ 1,086,405</u>

**Report on Internal Control Over Financial Reporting and on Compliance and Other
Matters Based on an Audit of Financial Statements Performed in Accordance With
Government Auditing Standards**

*Mayor and Municipal Legislature
Municipality of Rincon
Rincon, Puerto Rico*

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Rincon, Puerto Rico (the Municipality) as of and for the year ended June 30, 2004, and have issued our report thereon dated January 26, 2005 which is qualified because the Municipality has not determined and recorded in governmental activities an estimate of the total municipal solid waste landfill post closure care costs of a closed solid waste landfill, as required by accounting principles generally accepted in the United States of America and because we were unable to obtain sufficient and competent evidence to support the allocation of pool cash recorded as restricted cash and cash equivalents in the Commonwealth Legislative Grants Fund, because of the inadequacy of accounting records and reports. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items **2004 II-1** to **2004 II-3**.

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items **2004 II-1** to **2004 II-3** in the accompanying schedule of findings and questioned costs to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 2004 II-2.

We also noted certain additional matters that we reported to management of the Municipality in a separate letter dated January 26, 2005.

This report is intended for the information of the management of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.



Rodriguez, Rivera & Toro LLP

Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

*Mayor and Municipal Legislature
Municipality of Rincon
Rincon, Puerto Rico*

Compliance

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

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

We were unable to obtain sufficient documentation supporting the compliance of the Municipality with *Water and Waste Disposal Systems for Rural Communities* program regarding *Davis-Bacon Act* requirements, as described in the accompanying schedule of findings and questioned costs as item **2004 III-1**; and with *Grants for Public Works and Economic Development* program regarding *Reporting* requirements, as described in the accompanying schedule of findings and questioned costs as item **2004 III-5**, nor were able to satisfy ourselves as to Municipality's compliance with those requirements by other auditing procedures.

In our opinion, except for the effects of such compliance, if any, as might have been able to examine sufficient evidence regarding the Municipality's compliance with *Water and Waste Disposal Systems for Rural Communities* program regarding *Davis-Bacon Act* requirements and with *Grants for Public Works and Economic Development* program regarding *Reporting* requirements, the Municipality of Rincon, Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2004.

Internal Control over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2004 III-1 to 2004 III-7.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2004 III-1 and 2004 III-5 to be material weaknesses.

This report is intended for the information of the management of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.



Rodriguez, Rivera & Toro LLP

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2004

Section I - Summary of Auditor's Results:

Part I - Financial Statements

- Type of auditor's report issued: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
- Internal control over financial reporting:
- Material weaknesses identified? Yes No
 - Reportable conditions identified that are not considered to be material weaknesses? Yes None reported
- Noncompliance material to financial statements noted? Yes No

Part II - Federal Awards

- Internal control over major programs:
- Material weaknesses identified? Yes No
 - Reportable conditions identified that are not considered to be material weaknesses? Yes None reported
- Type of auditor's report on compliance for major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
- Audit findings disclosed that are required to be reported under Section 510(a) of OMB Circular A-133: Yes No

Identification of major programs:	CFDA Number	Name of Federal Program or Cluster
	10.760	Water and Waste Disposal Systems for Rural Communities
	11.300	Grants for Public works and Economic Development
	14.228	Community Development Block Grant - State's Program

- Dollar threshold used to distinguish between type A and type B programs: \$300,000
- Auditee qualified as low-risk auditee: Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2004 II-1
Area: Accounting records and reports
Type: Material Weakness

Criteria: The Municipality should establish internal control policies and procedures to maintain adequate, complete and reconciled accounting records and reports. Accounting principles generally accepted in the United States of America require financial transactions to be recorded in accounting records properly reconciled with subsidiaries or supporting records and reports.

Condition: Our tests to the Municipality's accounting records disclosed the following:

- (1). The Municipality has not maintained a general ledger to post and register its financial transactions. In addition, has not established a complete set of manual accounting records properly balanced and has not established procedures for reconciliation with the computerized accounting system. Certain records (such as "libro de caja") are not been properly maintained. The financial statements have been prepared from other alternative sources, including manual subsidiary records and reports.
- (2). There are no adequate controls over transactions recording and balances analysis related to Form 4(a) Monthly Cash Report since previous years. Several pooled cash account balances related to Commonwealth's Legislative resolutions disclose deficits or inappropriate ending balances as of June 30, 2004.
- (3). There are significant transactions and amounts included as reconciling items in bank conciliations of General Fund, one account related to Commonwealth's Legislative resolutions, CDBG, Public Order Code Fund, Local Law Enforcement Block Grant, Hurricane Georges, Water and Waste System Loan (Bo. Barrero), Edward Byrne and Child Care.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2004 II-1 - continued

Cause:	The Municipality has not established procedures to maintain a complete and reconciled set of accounting records. The Finance Department does not have trained personnel in accounting controls and personnel lacks of adequate supervision and monitoring of financial reporting process. Deficiencies related to Form 4(a) Monthly Cash Report are caused by accounting errors and interfund loans or advance payments not adjusted or reimbursed. Significant amounts included as reconciling items in bank conciliations arise primarily from amounts adjusted by banks but not in accounting records, amounts deposited into erroneous bank accounts and accounting errors.
Effect:	As a result of the inadequacy of accounting records in this area the financial statements have been prepared from other alternative sources, including manual subsidiary records and reports. In addition, we could not support the allocation of restricted cash and cash equivalents in the Commonwealth Legislative Grants
Recommendation:	The Municipality should start immediately an implementation process of a complete set of accounting records and reports properly reconciled. This process should include hiring or transfers of employees with knowledge of accounting principles related to governmental financial reporting. These personnel should be properly trained, monitored and supervised to assure achievement of financial reporting objectives. A review of Form 4(a) Cash Report pooled cash balances related to Commonwealth's Legislative resolutions is recommended to correct and report appropriate revenues, expenditures and cash cumulative balances.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2004 II-2
Area: **Interfund transactions - advances from/to other funds**
Type: **Material Weakness and material instance of noncompliance**

Criteria: The Municipality should not made loans from restricted grant funds for operational purposes as established by internal control policies and Municipal regulations. For loans already made, funds should be provided (from the general fund) to reimburse restricted grants funds.

Condition: Since previous years the general fund owed to the Commonwealth's Legislative Grants Funds \$694,738 which was advanced to finance certain operational transactions as follows:

- \$280,000 paid in June, 2000 to finance payroll expenditures,
- \$61,780 paid in December, 2000 to finance the Christmas bonus expenditures,
- \$352,958 paid in January 2, 2001 for payment of a settled legal case.

As of June 30, 2004 the Municipality has not provided funds to repay to the Commonwealth's Legislative Grants Fund the referred advances.

Cause: In fiscal year periods 1999-2000 and 2000-2001 the Municipality suffered cash flow problems. Funds were used from restricted grants to pay operational or unrestricted type expenditures. The Municipality has continued to have financial problems which, as stated by the Municipality's management, prevent to provide funds for reimbursement.

Effect: The Municipality has not complied with established by internal control policies and Municipal regulations. These advances have been recognized in the basic financial statements as advances from other funds and comprise a significant part of the general fund's fund balance.

Recommendation: The Municipality should enter into a payment plan to reimburse advanced funds to the Commonwealth's Legislative Grants Fund.

Views of responsible officials and planned corrective actions: See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2004 II-3
Area: **Interfund transactions – due from\to other funds**
Type: **Material Weakness**

Criteria:	Funds are temporarily advanced from general current bank account to other funds for salaries, fringe benefits and other costs incurred by several special accounts. Those advances should be subsequently reimbursed by the applicable Commonwealth and federal agencies based on billings prepared by the Municipality.
Condition:	The Municipality has no adequate billing and collection procedures established to assure proper and timely repayment of advances. Accounting of advances and reimbursements is also not adequate.
Cause:	The Municipality has not established controls and procedures for billing, collection of advances and accounting of advances and reimbursements.
Effect:	Several amounts are not being reimbursed or not timely reimbursed by the applicable agencies. The Municipality has suffered significant losses for uncollectible amounts, which has contributed to the unreserved general fund deficit and severely affected its cash flow.
Recommendation:	The Municipality should establish the referred controls and procedures including responsible personnel of processes. A complete review of uncollected balances since previous years should be performed to identify, bill and collect unclaimed funds from Commonwealth and Federal agencies.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Reference Number:	<u>2004 III-1</u>
Agency:	U. S. Department of Agriculture – Rural Development
Program:	Water and Waste Disposal Systems for Rural Communities
CFDA Number:	10.760
Project:	Construction of Sanitary Sewer System, Barreros Community
Regulation/Requirement:	Davis-Bacon Act
Type:	Material weakness, material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria:	As part of the requirements of the Davis-Bacon Act the contractor should submit to the non-federal entity weekly, for each week in which any contract is performed, a copy of the payroll and a statement of compliance (certified payrolls). The Municipality should establish procedures to verify and document payroll's review to determine that contractor is paying not less than prevailing wage rates as established in the construction contract.
Condition:	The Municipality has not performed the contractor's payrolls review.
Context:	Our tests disclosed that there is no evidence of review in all payrolls submitted by contractor.
Cause:	The Municipality has not assigned to a specific department or responsible employee duties related to contractor's payrolls review for compliance with Davis-Bacon Act requirements for Rural Development funds.
Effect:	There is no evidence to support the compliance of applicable requirement. Contractor might have pay at rates other than prevailing rates and not timely detected and corrected.
Recommendation:	The Municipality should assign to a specific department or responsible employee duties related to contractor's payrolls review to determine contractor's compliance with Davis-Bacon Act requirements for Rural Development funds.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Reference Number:	<u>2004 III-2</u>
Agency:	U. S. Department of Agriculture – Rural Development
Program:	Water and Waste Disposal Systems for Rural Communities
CFDA Number:	10.760
Project:	Construction of Sanitary Sewer System, Barreros Community
Regulation/Requirement:	Special Tests and Provisions - tests to accounting records for compliance with 7 CFR 3016.20 (b)
Type:	Reportable condition
Questioned Costs:	\$ -0-

Criteria: Accounting records - Grantees and sub-grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub-grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income.

Condition: A complete and balanced general ledger has not been maintained by the Municipality. Program transactions are recorded in revenue and expenditures subsidiary records.

Cause: Internal controls over recording and reconciliation of accounting records at the Municipality are inadequate.

Effect: Inadequate accounting records may cause the occurrence of errors and irregularities which may not be timely detected. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were obtained from other alternative sources, including manual subsidiary records and reports and the statement of deposits and withdrawals.

Recommendation: A complete and balanced general ledger should be maintained to post program transactions. Assigned personnel should be properly trained in accounting matters. The Municipality's Internal Auditor should perform tests to verify compliance with established internal control procedures.

Views of responsible officials and planned corrective actions: See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2004 III-3
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction of waterfront small business center - Award number 01-01-07582
Regulation/Requirement: Cash management, 13 CFR 305.24(a)
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: Program funds were requested to the Federal Government based on incurred costs. The Municipality should minimize the time elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursements to suppliers.

Condition: In 2 cases the Municipality has excess cash in bank for an unreasonable period on time after transfer of funds by the Federal Government.

Context: From a total of 8 reimbursement requests approved and deposited we noted the following:

- a. Funds of requests number 6 and 7 were deposited on April 30, 2004 but related payments were made on May 10, 2004.
- b. Funds of request number 8 were deposited on July 25, 2004 but related payment was made on September 10, 2004.

Cause: Program accounting controls were not adequate and there were no proper procedures established to determine excess cash available.

Effect: The Municipality has excess cash in bank account which do not permit compliance with requirement to reduce time elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursements to suppliers.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2004 III-3 - continued

Recommendation:	Program accounting control's deficiencies should be corrected and internal controls revised to avoid maintenance of excess cash on funds reimbursed by Federal Government based on incurred costs.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2004 III-4
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction of waterfront small business center - Award number 01-01-07582
Regulation/Requirement: Davis-Bacon Act
Type: Reportable condition
Questioned Costs: \$ -0-

- Criteria:** As part of the requirements of the Davis-Bacon Act, the contractor should submit to the non-federal entity weekly, for each week in which any contract is performed, a copy of the payroll and a statement of compliance (certified payrolls). The Municipality should establish procedures to verify and document payroll's review to determine that contractor is paying not less than prevailing wage rates as established in the construction contract.
- Condition:**
- a. The required certified payrolls were not submitted weekly. Payrolls were submitted in groups in specific dates.
 - b. There is no adequate evidence to support the contractor's payrolls review at the federal programs office.
- Context:**
- a. A sample of payrolls examined revealed that on September 11, 2003 the contractor submitted 16 weeks of payrolls of period from March 2003 to June 2003 and on April 21, 2004 submitted 8 weeks of payrolls from February 1, 2004 to March 27, 2004.
 - b. The employee at the federal programs office in-charge of wages rates review stated that payrolls were reviewed but we noted that approximately 90% of payrolls submitted include as evidence of review a checkmark near employee payment column but there is no signature of the responsible employee as evidence of the review process. Approximately 10% of the remaining payrolls have no evidence of review.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Reference Number: 2004 III-4 - continued

Cause:	The Municipality has not followed established procedures for compliance with applicable requirements. As disclosed by Federal Program Office employees, the Municipality have not assigned to a specific department or responsible employee duties related to contractor's payrolls review for compliance with Davis-Bacon Act requirements of this EDA grant.
Effect:	The Municipality is not in compliance with applicable requirements. The contractor might have paid at rates other than prevailing rates and not timely detected and corrected.
Recommendation:	The Municipality should assign to a specific department or responsible employee duties related to contractor's payrolls review to determine contractor's compliance with Davis-Bacon Act requirements for EDA grant. Management should enforce contractors to submit payrolls weekly and comply with regulations. Payrolls should include signature and conclusion of Municipality's employees as evidence of wage rates review.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Reference Number:	2004 III-5
Agency:	U. S. Department of Commerce
Program:	Grants for Public Works and Economic Development
CFDA Number:	11.300
Project:	Construction of waterfront small business center - Award number 01-01-07582
Regulation/Requirement:	Reporting
Type:	Material weakness, material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria:	As stated in the grant agreement between the Municipality and the federal grantor, the Municipality is required to submit to the federal agency a financial report that provides information on the amount of allowable project expenses that has been incurred but not claimed for reimbursement as of the end of the reporting period. The report would be as of September 30 of each year and must be submitted annually until the final grant payment is made by EDA. The report should be submitted to EDA no later than October 30 of each year. Standard Form 269A, Financial Status Report, should be used for this purpose.
Condition:	Financial report was not prepared by the Municipality.
Context:	Reports for periods ending September 30, 2003 and September 30, 2004 were not prepared by the Municipality. (See also Finding 2003 III-3 in prior year report).
Cause:	The Municipality has not established applicable procedures to comply with requirement.
Effect:	The Municipality did not comply with applicable requirement.
Recommendation:	The Municipality should assign personnel to prepare and submit the required financial status reports properly reconciled and in agreement with accounting records.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2004 III-6
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction and rehabilitation of Rural Enterprise and Service Center – Award Number 01-01-07584
Regulation/Requirement: Special Tests and Provisions - tests to accounting records for compliance with 13 CFR 143.20 (b)
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: Accounting records - Grantees and sub-grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub-grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income.

Condition: A complete and balanced general ledger has not been maintained by the Municipality. Program transactions are recorded in revenue and expenditures subsidiary records.

Cause: Internal controls over recording and reconciliation of accounting records at the Municipality are inadequate.

Effect: Inadequate accounting records may cause the occurrence of errors and irregularities which may not be timely detected. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were obtained from other alternative sources, including manual subsidiary records and reports.

Recommendation: A complete and balanced general ledger should be maintained to post program transactions. Assigned personnel should be properly trained in accounting matters
The Municipality's Internal Auditor should perform tests to verify compliance with established internal control procedures.

Views of responsible officials and planned corrective actions: See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2004 III-7
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State’s Program
CFDA Number: 14.228
Regulation/Requirement: Special Tests and Provisions - tests to accounting records for compliance with 25 CFR 85.20(b)
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: Accounting records - Grantees and sub-grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub-grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income.

Condition: Program general ledgers maintained by the Federal Programs Office are incomplete and not balanced.

Context: We examined the general ledger of Program Year 2003 and debits and credits have a difference of \$340,841 since general ledger does not include receivables, payables and income accounts.

Cause: Internal controls over recording and reconciliation of accounting records at the Federal Programs Office are inadequate. Personnel are not properly trained in accounting principles.

Effect: Inadequate accounting records may cause the occurrence of errors and irregularities which may not be timely detected. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were obtained from other alternative sources, including manual subsidiary records and reports and records from the Municipality’s centralized accounting system.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2004 III-7 - continued

Recommendation:

A complete review of the program records should be performed to assure that all transactions are adequately posted. As part of this process, records should be reconciled with centralized accounting records and pass-through entity records. Personnel should be trained in accounting matters and verification controls should be established between the Finance Department and the Federal Programs Office. The Municipality's Internal Auditor should perform tests to verify compliance with established internal control procedures.

**Views of responsible officials
and planned corrective
actions:**

See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2004

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Fiscal year ended June 30,	Finding No.	Condition	Status
2003	2003 II-1	The Municipality has not properly implemented and established internal controls and procedures to maintain adequate, complete and reconciled set of accounting records and reports.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). See current year finding number <u>2004 II-1</u> in the accompanying schedule of findings and questioned costs.
2003	2003 II-2	The Municipality received from the Commonwealth's Legislature certain grants funds which are restricted for specific purposes. Certain general fund expenditures have been financed with these restricted grants funds, which is not in accordance with grantor's established purposes.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). See current year finding number <u>2004 II-2</u> in the accompanying schedule of findings and questioned costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2004

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*-continued:

Fiscal year ended June 30,	Finding No.	Condition	Status
1998, 1999,2000, 2001 and 2002	98 II-1; 99 II-1; 2000 II-1; 2001 II-1; 2002 II-1	The Municipality has not established adequate controls and procedures to assure the completeness, existence and valuation of fixed assets inventories.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).
1998, 1999 and 2000	98 II-2; 99 II-2; 2000 II-2	a. Several instances of excess of expenditures over appropriations in the general fund. b. Operational budgetary deficit and cumulative fund balance deficit (GAAP).	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).
1997, 1998, 1999,2000, 2001 and 2002	97 II-1; 99 II-3; 2000 II-3; 2001 II-3; 2002 II-2	Failure to properly implement established internal controls and procedures to maintain complete, accurate and reliable set of accounting records and reports.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2004

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*-continued:

Fiscal year ended June 30,	Finding No.	Condition	Status
1997	97 II-2	<p>During our examination of internal controls and procedures over the bid process we noted that there was an awarded bid for a construction project of \$3,082,000 where the appropriated budget was \$2,500,000 to cover the awarded bid costs. As stated on the bid board minutes, the bid was awarded based on the recommendation of the Recreational Development Company of Puerto Rico (a state governmental agency). This recommendation authorized the Municipality to award the bid for the budget amount the Municipality has available with an agreement to obtain the total additional funds within six months. The Municipality decided to contract the construction project in three stages based on availability of funds. The total amount of the three stages was \$2,715,000, which represents \$318,000 above the original estimated construction costs. As stated in communications between the contractor and the Municipality, the excess costs are based on changes in costs for the additional time incurred and extended overhead cost.</p>	<p>Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-1	Our tests to a sample of 7 participant's files (from a population of 16 files) of the materials donation program disclosed that certain documents were missing from files.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).
2003	US Department of Commerce: Grants for Public Works and Economic Development Facilities - CFDA No. 11.300	2003 III-2	Matching funds were not provided by the Municipality as of the date of the bid as required by grant agreement and the Municipality should obtain \$19,671 to complete matching requirements.	Remaining funds were obtained by the Municipality in fiscal year 2003-2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of Commerce: Grants for Public Works and Economic Development Facilities - CFDA No. 11.300	2003 III-3	As stated in the grant agreement between the Municipality and the federal grantor the Municipality is required to submit to the federal agency a financial report that provides information on the amount of allowable project expenses that has been incurred but not claimed for reimbursement as of the end of the reporting period. The report would be as of September 30 of each year and must be submitted annually until the final grant payment is made by EDA. The report should be submitted to EDA no later than October 30 of each year. The referred report have not been prepared and submitted by the Municipality.	Finding not cleared. See current year finding number 2004 III-5 in the accompanying schedule of findings and questioned costs.
2003	US Department of Commerce: Grants for Public Works and Economic Development Facilities - CFDA No. 11.300	2003 III-4	The Municipality is required to establish and place in operation adequate internal controls to provide reasonable assurance that contractors paid the prevailing wages rates for projects covered by the Davis-Bacon Act. Our tests disclosed that there is no evidence that the Municipality is performing on-site visits to monitor classifications and wage rates.	Finding not cleared. See current year finding number 2004 III-4 in the accompanying schedule of findings and questioned costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of Commerce: Grants for Public Works and Economic Development Facilities - CFDA No. 11.300	2003 III-5	The Municipality is required to establish and place in operation adequate internal controls to require each of its contractors employed in the completion of the project to comply with procurement, suspension and debarment policies. There is no evidence of project contractor's certification of compliance with referred requirements.	Finding not cleared.
2003	US Department of Commerce: Grants for Public Works and Economic Development Facilities - CFDA No. 11.300	2003 III-6	The project contractor was obligated to make a documented good faith effort on this project to employ the unemployed/underemployed residents of the Municipality of Rincon. Records should be provided to the Municipality. There is no evidence of compliance with this requirement.	Finding not cleared.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Fiscal year ended June 30,	Program	No.	Condition	Status
2002	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2002 III-1	Our tests to a sample of six participant's files of materials donations program financed with SBGP funds disclosed that the certain documents were missing from files.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).
2001	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2001 III-1	In our tests related to procurement procedures we noted that in two bids for asphalt services and in one case related to the acquisition of a vehicle the Municipality could not provide evidence of proper evaluation and criteria for bidder selection.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2001	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2001 III-2	Municipalities are required to request from contractors a certification stating that Entity's Principals are not suspended or debarred from doing business with state or Federal Government or this requirement may be included as a contract's clause. During our examination on three of the Municipality's contracts over \$100,000 we noted that in two cases such clauses were not included in contract nor a certification was obtained from contractors.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).
2000	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2000 III-1	A service contract not provided for examination.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). Related questioned costs of \$548,751 remains unclear.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
1997	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	97 III-1	During our internal controls tests over the federal funds we found that grantee has not established procedures to comply with suspension and debarment requirement.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).



SECRETARÍA DE RECLAMACIONES E INTERVENCIÓN
AUG-8 PM 4:24

Estado Libre Asociado de Puerto Rico
Gobierno Municipal
Rincón, Puerto Rico 00677

División de Finanzas

RECIBIDO
05 AUG -5 PM 1:10
UNIDAD DE CORREO
Castillo M. 9176

Hoja de Trámite Documentos

A : Oficina del Comisionado de Asuntos Municipales
Atn: Lcdo. Ángel M. Castillo Rodríguez
Comisionado

Nilsa Soto Rosado

DE : Nilsa Soto Rosado
Directora de Finanzas

FECHA : 3 de agosto de 2005

ASUNTO : Adjunto Single Audit para el Año Fiscal terminado en junio 30, 2004.

COMENTARIO : Adjunto sobre pre-dirigido para devolverlo a nuestro auditores de Rodríguez, Rivera & Toro.

RECIBIDO POR : *Carolina Rivera Aguiar*

FECHA DE RECIBO : 15 de agosto de 2005

ADVERTENCIA DE CONFIDENCIALIDAD: Este documento incluyendo todos los documentos que le acompañan es para el uso exclusivo del destinatario. Si el recipiente no es el destinatario o no está autorizado por éste a leer su contenido, se le Advierte que su contenido es de la propiedad de nuestro Municipio y que puede contener información de naturaleza privilegiada por la ley. Esta transmisión no constituye una renuncia al privilegio de confidencialidad ni una autorización a su uso en manera alguna por personas no autorizadas. La reproducción o fotocopia de dichos documentos está absolutamente prohibido. Si usted recibe este facsímil por equivocación, le agradeceremos nos llame al 787-823-2180, para hacer los arreglos necesarios para que sean devueltos.

Municipality of Rincón
Findings and Corrective Actions
Year ended June 30, 2004

Reference number: 2004 II-1

Area : Accounting records and report

Type : Material Weakness

Recommendation : The Municipality should start immediately an implementation process of a complete set of accounting records and reports properly reconciled. This process should include hiring or transfers of employees with knowledge of accounting principles related to governmental financial reporting. These personnel should be properly trained, monitored and supervised to assure achievement of financial reporting objectives. A review of Form 4 (a) Cash Report pooled cash balances related to Commonwealth's Legislative resolutions is recommended to correct and report appropriate revenues, expenditures and cash cumulative balances.

Corrective Actions:

- a) The Finance Department will give priority to properly implement and establish internal controls and procedures to maintain adequate, complete and reconciled set of accounting records and reports.
- b) Actually we are identifying the funds and adjustments between the bank accounts and Commonwealth's Legislative Funds.
- c) The Finance Department will perform the implementation process of a complete set of accounting records and reports properly reconciled.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 II-2
Area : Interfund transactions - advances from\to other funds
Type : Material Weakness and material instance of noncompliance

Recommendation : The Municipality should enter into a payment plan to reimburse Advanced funds to the Commonwealth's Legislative Grants Fund.

Corrective Action : The Municipality in the future will consider to establish the payment plan without affecting essentials services to citizens.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number : 2004 II-3
Area : Inter-fund transactions - due from \ to other funds
Type : Material Weakness

Recommendation : The Municipality should establish the referred controls and procedures including responsible personnel of processes. A complete review of uncollected balances since previous years should be performed to identify, bill and collect unclaimed funds from the Commonwealth and Federal agencies.

Corrective Action : The Municipality will establish controls and procedures for the billing, collection of advances payments and current reimbursements. Also we will identify additional personnel in the Finance Department to establish these control measures.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 III-1
Agency : U.S. Department of Agriculture- Rural Development
Program : Water and Wasted Disposal Systems for Rural Communities
CFDA Number : 10.760
Project : Construction of Sanitary Sewer Systems, Barreros Community
Regulation : Davis-Bacon Act
Type : Material Weakness and material instance of noncompliance
Questioned Costs : \$-0-

Recommendation : The Municipality should assign to a specific department or responsible employee duties related to contractor's payrolls review to determine contractor's compliance with Davis-Bacon Act requirements for Rural Development funds.

Corrective Action: The Municipality will assign a specific person to review future contractor's payroll review and determine contractor's compliance with Davis-Bacon Act requirements for Rural Development funds.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 III-2
Agency : U.S. Department of Agriculture- Rural Development
Program : Water and Wasted Disposal Systems for Rural Communities
CFDA Number : 10.760
Project : Construction of Sanitary Sewer Systems, Barreros Community
Regulation : Special Test and Provisions – tests to accounting records for
Compliance with 7 CFR 3016.20 (b)
Type : Reportable condition
Questioned Costs : \$-0-

Recommendation : A complete and balanced general ledger should be maintained to post program transactions. Assigned personnel should be properly trained in accounting matters.
The Municipality's Internal Auditor should perform test to verify Compliance with established internal control procedures.

Corrective Action: The Municipality's Internal Auditor will perform tests to verify compliance with established internal control procedures and will assure that a balanced general ledger will be maintained.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 III-3
Agency : U.S. Department of Agriculture- Rural Development
Program : Grants for Public Works and Economic Development
CFDA Number : 11.300
Project : Construction of waterfront small business center – Award number
01-01-07582
Regulation : Cash management, 13 CFR 305.24 (a)
Type : Reportable condition
Questioned Costs : \$-0-

Recommendation: Program accounting control's deficiencies should be corrected and Internal controls revised to avoid maintenance of excess cash on funds reimbursed by Federal Government on incurred costs.

Corrective Action: The deficiencies of the program accounting control will be corrected and the internal controls revised , also the municipality will try to minimize the elapse time between transfer of funds. This was caused because the lack of experience in utilizing these Federal Government funds.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 III-4
Agency : U.S. Department of Commerce
Program : Grants for Public Works and Economic Development
CFDA Number : 11.300
Project : Construction of waterfront small business center – Award number
01-01-07582
Regulation : Davis Bacon Act
Type : Reportable condition
Questioned Costs : \$-0-

Recommendation: The Municipality should assign to a specific department or responsible employee duties related to contractor's payrolls review to determine contractor's compliance with Davis-Bacon Act requirements for EDA grant. Management should enforce contractors to submit payrolls weekly and comply with regulations. Payrolls should include signature and conclusion of Municipality employees as evidence of wage rates review.

Corrective Action The Municipality will assign a specific person immediately to review on going project payroll reviews and determine contractors compliance with Davis-Bacon Act requirements for EDA grant.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 III-5
Agency : U.S. Department of Commerce
Program : Grants for Public Works and Economic Development
CFDA Number : 11.300
Project : Construction of waterfront small business center – Award number
01-01-07582
Regulation : Reporting
Type : Material weakness, material instance of noncompliance
Questioned Costs : \$-0-

Recommendation : The Municipality should assign personnel to prepare and submit the required financial status reports properly reconciled and in agreement with accounting records.

Corrective Action : The Financial Report will be prepared and submitted by the Finance Director immediately. The future annual report will be submitted to EDA no later than October 30 of each year until final grant payment.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

Reference number: 2004 III-6
Area : Construction of waterfront small business center – Award number
01-01-07582
Project : Construction and rehabilitation of Rural Enterprise and Service
Center – Award Number 01-01-07584
Regulation : Special Test and Provisions – tests to accounting records for
compliance 13 CFR 143.20 (b)
Type : Material weakness, material instance of noncompliance
Questioned Costs : \$-0-

Recommendation: A complete and balanced general ledger should be maintained to
Post program transactions. Assigned personnel should be properly
trained in accounting matters.
The Municipality's Internal Auditor should perform tests to verify
Compliance with established internal control procedures.

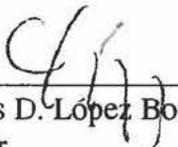
Corrective Action: The Federal Programs Director will request additional training in
accounting matters and verification controls The Municipality will
insure the Internal Auditor will perform the required tests to verify
compliance with the established internal control procedures.

Municipality of Rincón
Findings and Corrective Actions - Continued
Year ended June 30, 2004

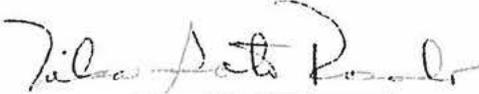
Reference number: 2004 III-7
Agency : U.S. Department of Housing and Urban Development
Office of Commissioner of Municipal Affairs (OCAM)
Program : Community Development Black Grant –State Program
Regulation : Special Test and Provisions – tests to accounting records for
compliance 25 CFR 85.20 (b)
Type : Reportable condition
Questioned Costs : \$-0-

Recommendation : A complete review of the program records should be performed to assure that all transactions are adequately posted. As part of this process, records should be reconciled with centralized accounting records and pass-through entity records. Personnel should be trained in accounting matters and verifications controls should be established between the Finance Department and the Federal Programs Office. Internal Auditor should perform test to verify compliance with established internal control procedures.

Corrective Action : The Federal Programs Director will request additional training in accounting matters and verification controls at the Office of the Commissioner of Municipal Affairs (OCAM). Also will request the Mayor to insure the Municipal Internal Auditor perform tests to verify compliance with the established internal control procedures which are part of his duties and responsibilities in this Municipality.



Carlos D. López Bonilla
Mayor



Nilsa Soto Rosado
Finance Director

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

FISCAL YEAR ENDED JUNE 30, 2004

Amf 1/1-808

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

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Independent Auditor's Report

*Mayor and Municipal Legislature
Municipality of Rincón
Rincón, Puerto Rico*

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Rincon, Puerto Rico, as of and for the year ended June 30, 2004, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As more fully described in Note G to the financial statements, the Municipality has not determined and recorded in governmental activities an estimate of the liability of the municipal solid waste landfill post closure care costs of a closed solid waste landfill. Accounting principles generally accepted in the United States of America requires that the liability of post closure care costs be accounted, which would increase liabilities and decrease net assets of governmental activities. The amount by which this departure would affect the liabilities of the governmental activities is not reasonably determinable.

We were unable to obtain sufficient and competent evidence to support the allocation of pool cash recorded as restricted cash and cash equivalents in the Commonwealth Legislative Grants Fund because of the inadequacy of accounting records and reports, which do not permit the application of adequate alternative procedures.

In our opinion, except for the effects, if any, of not determining and recording the estimate of solid waste landfill post closure care costs of a closed solid waste landfill in governmental activities, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the governmental activities of the Municipality of Rincon as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient evidence to support the allocation of pool cash recorded as restricted cash and cash equivalents in the Commonwealth Legislative Grants Fund, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Commonwealth Legislative Grants Fund of the Municipality of Rincon as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the General Fund, Economic Development Administration Grant Fund, the Debt Service Fund, the \$1,660,000 Bond Issuance Fund, the Community Development Grant Fund, the Law No. 52 Fund and the aggregate remaining fund information of the Municipality of Rincon as of June 30, 2004, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 9 and the Budgetary Comparison Schedule – General Fund on page 43 are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Rodriguez, Rivera & Toro LLP

MUNICIPALITY OF RINCON, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004

Our discussion and analysis of the Municipality of Rincón financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the financial statements, which begin on page 10.

FINANCIAL HIGHLIGHTS

- The asset of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2004 by \$17,423,635 (net assets), of which \$16,386,983 were invested in capital assets (net of accumulated depreciation, and related debt) and \$4,458,450 were restricted. The unrestricted fund balance has a negative balance of \$3,421,800.
- The Municipality's total net assets increased by \$4,360,085 from previous year restated balance.
- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$4,547,809, an increase of \$365,330 in comparison with the prior year.
- The General Fund, on a current financial resources basis, reported deficiency of revenues, and other financing sources over expenditures and other financing uses of (\$6,606), after revenues from property tax amnesty of \$196,555, and an unreserved negative fund balance of (\$464,600).
- On a budgetary basis, actual revenues exceeded actual expenditures by \$236,048.
- Long term debt decreased by \$42,980 approximately 1 percent with respect to prior year.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 10 through 11) provide information about the activities of the Municipality as a whole and present a long-term view of the Municipality's finances. Fund financial statements start on page 12. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements report the Municipalities' operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds.

Reporting the Municipality as a Whole

The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Municipality's *net assets* and changes in them. You can think of the Municipality's net assets, the difference between assets and liabilities, as one way to measure the Municipality's financial health, or *financial position*. Over time, *increases or decreases* in the Municipality's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the Municipality's property tax base and the condition of the roads, to assess the *overall health* of the Municipality of Rincón.

In the Statement of Net Assets and the Statement of Activities, we showed the Municipality activities:

MUNICIPALITY OF RINCON, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004

- Governmental activities – Most of the Municipality's basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, state and federal grants finance most of these activities.

Reporting the Municipality's Most Significant Funds

Fund Financial Statements

Our analysis of the Municipality's major funds begins on page 7. The Fund financial statements begin on page 12 and provide detailed information about the most significant funds, not the Municipality as a whole. Some funds are required to be established by bond covenants.

The Municipality's basic services are reported in the governmental funds, that uses an accounting approach which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Municipality's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation on pages 13 and 15 of this report.

THE MUNICIPALITY AS A WHOLE

During the year the Municipality performed an evaluation of the amount reported as capital asset for the year ended June 30, 2003. As result of the evaluation the Municipality management supported evidence to increase the balance of the capital assets account shown in the financial statement of prior year.

Also the management performed adjusting entries to the accounting records which also affect the ending fund balance as of June 30, 2003.

The ending balance shown as net assets at the end of the June 30, 2003 was \$8,533,502. After recording the adjustment to the accounting records this ending net asset balance (current year's beginning as restated) increased to \$13,063,550.

The changes in fund balance during the year ended June 30, 2004 was \$365,335.

Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 3) of the Municipality's governmental activities.

MUNICIPALITY OF RINCON, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004

Table 1

Net Assets

Governmental Activities

	2004	2003 as restated	Change	%
Current and other assets	\$ 7,232,346	\$ 5,751,083	\$ 1,481,263	26%
Capital assets	18,700,962	14,956,742	3,744,220	25%
Total Assets	\$ 25,933,308	\$ 20,707,825	\$ 5,225,483	25%
Other liabilities	\$ 1,981,286	\$ 1,072,907	908,379	85%
Long term debt outstanding	6,528,387	6,571,368	(42,981)	-1%
Total liabilities	\$ 8,509,673	\$ 7,644,275	865,398	11%
Net Assets				
Investment in Capital Assets, net of related debt	\$ 16,386,983	\$ 13,786,572	\$ 2,600,411	19%
Restricted for:				
Debt services	483,966	96,265	387,701	403%
Capital projects	3,293,120	2,127,222	1,165,898	55%
Other specified purposes	681,364	1,038,181	(356,817)	-34%
Unrestricted	(3,421,800)	(3,984,690)	562,890	14%
Total net assets	\$ 17,423,635	\$ 13,063,550	\$ 4,360,083	33%

Governmental Activities

Revenues for the Municipality's governmental activities increase by 24% (\$2,653,985) while total expenses increased by 16% (\$1,472,346). The increase in revenues was due primary to a positive change of \$2,496,951 or 102% in capital grants and contributions. The expenses related to welfare increased by \$1,610,162 mostly due to an increase in federal programs grants.

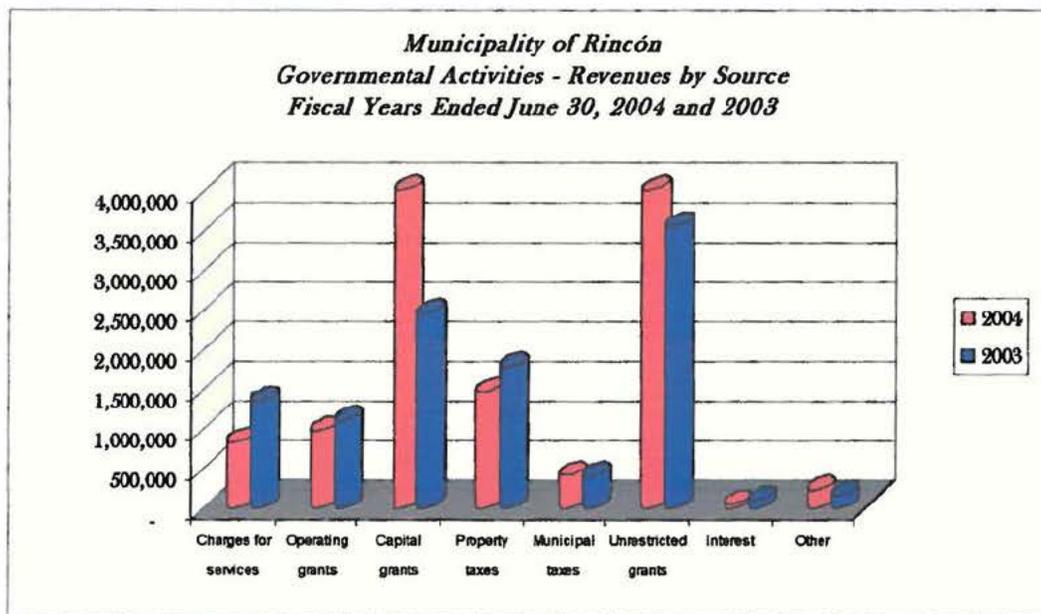
The following table summarizes the changes in net assets for the fiscal years ended 2004 and 2003

Table 2
Changes in Net Assets
Governmental Activities

	2004	% of Total	2003 as restated	Change	% of Change
Revenues:					
Program revenues:					
Charges for services	\$ 817,050	6%	\$ 1,338,368	(521,318)	-39%
Operating grants and contributions	963,872	7%	1,098,261	(134,389)	-12%
Capital grants and contributions	4,950,916	37%	2,453,965	2,496,951	102%
General revenues:				-	
Property taxes	1,457,846	11%	1,770,982	(313,136)	-18%
Municipal taxes	410,613	3%	400,253	10,360	3%
Other grants and contributions	4,633,049	35%	3,539,385	1,093,664	30%
Interest	36,342	0%	88,121	(51,779)	-59%
Other	223,055	1%	149,424	73,631	49%
Total revenues	\$ 13,492,744	100%	10,838,759	2,653,985	24%

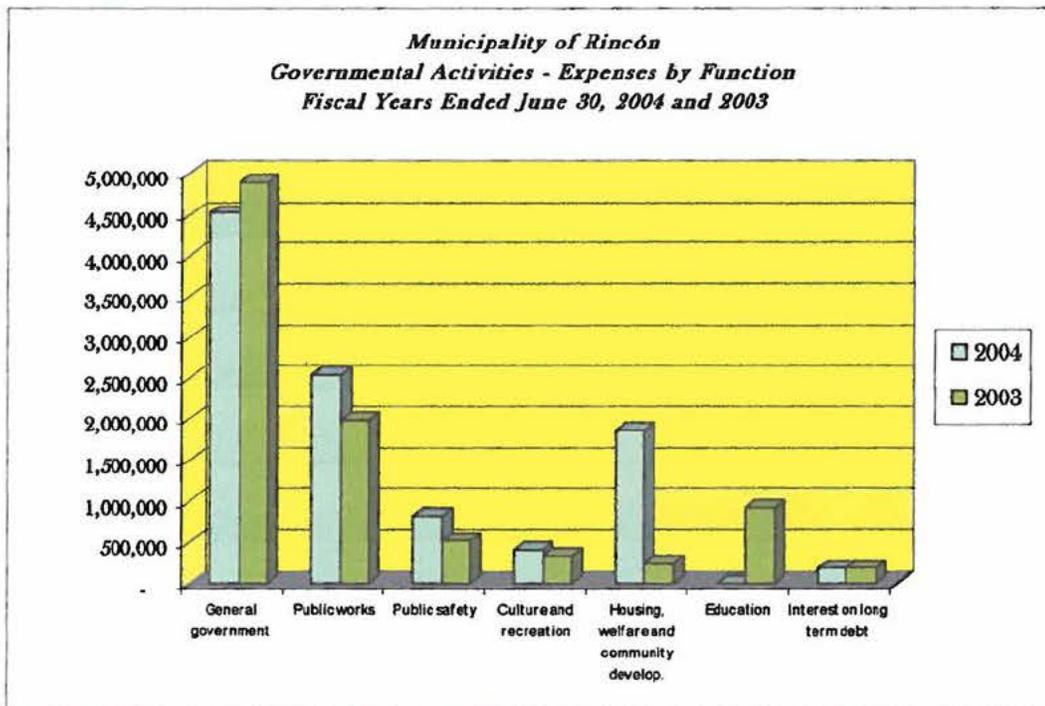
MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004

Expenses:						
General government	4,519,444	43%	4,903,668	(384,224)	-8%	
Public Safety	826,520	8%	526,027	300,493	57%	
Public Works	2,798,143	25%	1,992,514	805,629	40%	
Welfare	1,862,555	18%	252,393	1,610,162	638%	
Culture and recreation	416,780	4%	355,153	61,627	17%	
Education	5,416	0%	924,183	(918,767)	-99%	
Interest on long-term debt	186,593	2%	189,168	(2,575)	-1%	
Total expenses	10,615,452	100%	9,143,106	1,472,346	16%	
Increase(decrease) in net assets	2,877,292		1,695,653	1,181,639	70%	
Special items						
Property tax amnesty	251,830		-	251,830	-	
Transfer of land and recreational facilities	1,230,963		-	1,230,963	-	
Increase in net assets	4,360,085		1,695,653	2,664,432	157%	
Net assets at beginning of year						
as restated	13,063,550		11,367,897	1,695,653	15%	
Net assets end of year	<u>\$ 17,423,635</u>		<u>\$ 13,063,550</u>	<u>\$ 4,360,085</u>	33%	



Approximately 35% of the Municipality's revenues came from grants and contributions not restricted to specific programs, 44% from operating and capital grants and 11% from property taxes. Revenues (not including special items) increased by 24% in comparison with year 2003. The most significant change, considering its participation in total revenues, is a 30% increase grants and contributions not restricted to specific programs.

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004



The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 43%, public works and sanitation with 25% and welfare with 18%. Program revenues of the Municipality covered 60% of total expenses.

Expenses increased 16% in comparison with previous year. This includes a net difference of an increase in housing, welfare and community development due to additional costs related primarily to federal grants; a 57% increase in public safety (due to the payment of extra hours and bonus to municipal police) and a 40% increase in public works and sanitation (due to additional capital assets maintenance and other noncapitalizable costs). Changes in net assets in 2004 include additional resources from property tax amnesty in the amount of \$251,830 which was reported as a special item in the financial statements.

As noted previously the increase in revenues combined with an increase in expenses caused the net change in net assets to increase approximately 157% compared with net change in net assets reported in 2003 statement of activities.

THE MUNICIPALITY'S FUND

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the fiscal year ended June 30, 2004, the governmental funds reported combined ending fund balances of \$4,547,809 a net increase of \$365,335 in comparison with the prior year. This increase was caused primarily by a net change in Commonwealth Legislature Resolution Fund of \$1,448,105 and \$222,927 in Other Governmental Funds. Of total combined fund balances, \$(960,543) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents 22% of total combined ending fund balance. For the year ended June 30, 2004, the fund balance of the general fund decreased by \$6,606. The key factor of this change is a net decrease of \$361,413 in other special funds with self imposed restrictions included as part of the general fund. Resources to finance these special funds were provided in previous years but funds were expended in current year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Investment in capital assets for governmental activities as of June 30, 2004, amounted to \$16,386,983 millions (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, park facilities, roads, bridges and construction in progress.

Capital assets as of June 30, 2004 and 2003 follow:

Table 4
Capital Assets, net
As of June 30,

	Governmental Activities	
	2004	2003 (as restated)
Non-depreciable assets:		
Land and improvements	\$ 3,104,358	\$ 2,060,618
Construction in progress	2,953,381	1,961,902
Depreciable assets:		
Buildings and improvements	7,604,421	5,576,554
Vehicules, machinery and equipment	2,387,084	2,546,431
Infrastructures	2,651,718	2,811,237
Total	\$ 18,700,962	\$ 14,956,742

Significant capital projects underway in construction in progress included the following:

Improvements to Recreational Square	\$ 937,233
Improvements to City Hall	\$ 1,477,228
Barrero Sewer System	\$ 341,722
Infrastructure improvements	\$ 197,196

This year's major capital assets additions (approximately) included:

- \$1,230,963 of land and property donated by the Puerto Rico Department of Recreation and Sports.
- \$1,229,150 Sunset Enterprises Village.

More detailed information about the Municipality's capital assets and future projects is presented in Note E to the financial statements.

MUNICIPALITY OF RINCON, PUERTO RICO
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE YEAR ENDED JUNE 30, 2004

Debt

Debt Administration

Long term debt as of June 30, 2004 and 2003 follows:

	Outstanding Long-term Debt	
	Fiscal years ended June 30,	
	Governmental Activities	
	2004	2003 (as restated)
Bonds and notes payable	\$ 3,899,000	\$ 4,261,000
Compensated absences	702,654	581,873
Claims and judgments	-	246,173
Bond anticipation note	530,000	-
Payable to CRIM –delinquent accounts	142,472	165,479
Christmas Bonus Payable	181,764	167,418
PR Dept of Labor–Unemployment payment plan	329,186	464,188
CRIM-property tax 6/30/99 and 6/30/00 (Ley 42)	464,571	470,663
CRIM- property tax advances current year	88,520	-
P.R. Department of Treasury-6/30/93 property tax	51,749	61,765
LIMS debt	138,471	152,749
Total	\$ 6,528,387	\$ 6,571,308

At the end of the current fiscal year, the Municipality had a total bonded debt and notes payable outstanding of \$3,899,000. Other obligations include a \$530,000 bond anticipation loan, accrued Christmas bonus, compensated absences and vacation and sick days, and a debt to the Municipal Revenue Collection Center (CRIM). Compensated absences and vacations are paid when due.

More detailed information about the Municipality's long term liabilities is presented in Note F to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2004-2005 budget. The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2005 are \$ 6,791,292 an increase of approximately 6% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. The construction industry has been one of the major sources of income generated by the Municipality, in the construction of personal housing, contributing with construction.

CONTACTING FINANCE DIRECTOR

This financial report is design to provide our citizens, taxpayers and customers and creditors with a general overview of the Municipality finances and to show accountability for the money it receives. If you have any questions about this report or need any additional information contact the Finance Department at the Municipality of Rincon, PO Box 97, Rincón, P.R. 00677.

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**STATEMENT OF NET ASSETS
JUNE 30, 2004**

	Governmental Activities
ASSETS	
Cash and cash equivalents	\$ 946,920
Due from:	
Commonwealth Governmental entities (note C)	791,819
Federal Government (note C)	645,978
Restricted assets:	
Cash and cash equivalents	3,571,261
Cash with fiscal agent	1,276,368
Capital Assets (note E):	
Nondepreciable assets:	
Land and construction in progress	6,057,738
Depreciable assets	
Buildings, infrastructure, equipment and other	12,643,223
 Total capital assets, net	 18,700,962
 Total assets	 \$ 25,933,308
 LIABILITIES	
Accounts payable	\$ 1,442,559
Accrued payroll taxes and withholdings	42,646
Due to:	
Commonwealth Governmental entities (note C)	43,664
Accrued interest payable	60,862
Deposits payable	5,300
Deferred revenues:	
Municipal License taxes	330,057
Intergovernmental-Commonwealth agencies	33,606
Federal grants	22,592
Long term liabilities (note F):	
Due within one year	826,683
Due in more than one year	5,701,704
Total liabilities	8,509,673
 NET ASSETS	
Invested in capital assets, net of related debt	16,386,983
Restricted for:	
Debt service	483,966
Capital Projects	3,293,120
Other specified purposes	681,364
Unrestricted (deficit)	(3,421,800)
 Total net assets	 \$ 17,423,635

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2004**

<u>Functions</u>	<u>Program Revenues</u>			<u>Net (expense) revenue and changes in net assets</u>	
	<u>Expenses</u>	<u>Fees, Fines and Charges for services</u>	<u>Operating Grants and Contributions</u>		<u>Capital Grants and Contributions</u>
Governmental Activities:					
General government	\$ 4,519,444	\$ 817,050	\$ 494,258	\$ -	\$ (3,208,136)
Public works and sanitation	2,798,143	-	-	3,081,771	283,628
Public safety	826,520	-	81,715	-	(744,805)
Culture and recreation	416,780	-	1,394	-	(415,386)
Education	5,416	-	-	-	(5,416)
Welfare and community development	1,862,555	-	386,506	1,869,145	393,096
Interest on long term debt	186,593	-	-	-	(186,593)
Total	<u>\$10,615,452</u>	<u>\$ 817,050</u>	<u>\$ 963,872</u>	<u>\$ 4,950,916</u>	<u>(3,883,613)</u>

General revenues :

Property taxes	1,457,846
Municipal licenses taxes	410,613
Grants contributions not restricted to specific programs	4,633,049
Interests	36,342
Rent	49,390
Other	173,665

Special items (note P) :

Property taxes-amnesty	251,830
Transfer of land and recreational facilities	1,230,963
Total general revenues and special items:	<u>8,243,698</u>

Change in net assets	4,360,085
Net assets-beginning, as restated (note K)	13,063,550
Net assets-ending	<u>\$ 17,423,635</u>

The accompanying notes are an integral part of these statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2004

	General Fund	Commonwealth Legislative Resolutions	Economic Development Administration Grant	Debt Service	\$1,660,000 Bond Issuance	Community Development Block Grant Program	Law no. 52	Other Governmental Funds	Total Governmental Funds
ASSETS									
Cash and cash equivalents	\$ 543,272	\$ -	\$ 184,328	\$ -	\$ -	\$ 3,190	\$ -	\$ 216,130	\$ 946,920
Due from:									
Commonwealth Governmental entities	104,493	-	-	27,833	-	-	329,500	239,111	700,937
Federal Government	-	-	132,079	-	-	471,820	-	42,078	645,978
Other funds	840,531	-	-	-	-	-	-	42,832	883,362
Advances to other funds	-	694,758	-	-	-	-	-	5,010	699,768
Restricted assets:									
Cash and cash equivalents	17,859	3,199,796	-	-	-	-	-	353,606	3,571,261
Cash with fiscal agent	9,559	-	-	503,707	763,103	-	-	-	1,276,368
Total assets	\$ 1,515,713	\$ 3,894,554	\$ 316,407	\$ 531,540	\$ 763,103	\$ 475,010	\$ 329,500	\$ 898,767	\$ 8,724,593
LIABILITIES									
Accounts payable	\$ 318,998	\$ -	\$ 147,948	\$ -	\$ 179,580	\$ 391,364	\$ -	\$ 404,671	\$ 1,442,559
Accrued payroll taxes and withholdings	42,646	-	-	-	-	-	-	-	42,646
Matured bonds and notes payable	-	-	-	275,000	-	-	-	-	275,000
Matured interests payable	-	-	-	47,574	-	-	-	-	47,574
Due to:									
Commonwealth Governmental entities	43,664	-	-	-	-	-	-	-	43,664
Other funds	-	-	168,437	-	-	83,646	495,944	135,336	883,362
Advances from other funds	699,768	-	-	-	-	-	-	-	699,768
Deposits payable	5,300	-	-	-	-	-	-	-	5,300
Deferred revenues:									
Municipal License taxes	330,057	-	-	-	-	-	-	-	330,057
Intergovernmental-Commonwealth entities	-	-	-	-	-	-	329,500	54,762	384,262
Federal grants	-	-	-	-	-	-	-	22,592	22,592
Total liabilities	1,440,433	-	316,385	322,574	179,580	475,010	825,444	617,360	4,176,784
FUND BALANCES									
Reserved for:									
Encumbrances	21,982	-	-	-	-	-	-	-	21,982
Debt Service	-	-	-	208,966	-	-	-	-	208,966
Capital projects	-	3,199,796	22	-	583,523	-	-	278,672	4,062,013
Other specified purposes	517,898	-	-	-	-	-	-	2,735	520,633
Advances	-	694,758	-	-	-	-	-	-	694,758
Unreserved	(464,600)	-	-	-	-	-	(495,944)	-	(960,543)
Total fund balances	75,280	3,894,554	22	208,966	583,523	-	(495,944)	281,407	4,547,809
Total liabilities and fund balances	\$ 1,515,713	\$ 3,894,554	\$ 316,407	\$ 531,540	\$ 763,103	\$ 475,010	\$ 329,500	\$ 898,767	\$ 8,724,593

The accompanying notes are an integral part of these statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2004

Total fund balances- governmental funds	\$	4,547,809
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Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:		18,700,962
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Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:

Christmas bonus reimbursement receivable		90,882
Law No. 52 funds receivable		329,500
Others		21,156

Interest liabilities are not due and payable in the current period period and therefore, are not reported in the funds:		(13,286)
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Some liabilities, including bonds payable, are not due and payable in current period and therefore are not reported in the funds:		(6,253,388)
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Net assets of governmental activities:	\$	<u>17,423,635</u>
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The accompanying notes are an integral part of these statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	Commonwealth Legislative Resolutions	Economic Development Administration Grant	Debt Service	\$1,660,000 Bond Issuance	Community Development Block Grant Program	Law No. 52	Other Governmental Funds	Total Governmental Funds
REVENUES									
Property taxes (note H)	\$ 977,875	\$ -	\$ -	\$ 479,971	\$ -	\$ -	\$ -	\$ -	\$ 1,457,846
Municipal license taxes (note I)	410,613	-	-	-	-	-	-	-	410,613
Intergovernmental: (note J)									
Commonwealth entities	4,698,940	2,030,142	-	-	-	-	164,750	473,920	7,367,752
Federal grants	-	-	665,452	-	-	1,869,145	-	378,044	2,912,641
Licenses, permits and other local taxes	651,935	-	-	-	-	-	-	-	651,935
Fees, fines and charges for services	165,115	-	-	-	-	-	-	-	165,115
Interest	33,470	-	-	2,872	-	-	-	-	36,342
Rent	49,390	-	-	-	-	-	-	-	49,390
Other	169,830	3,835	-	-	-	-	-	-	173,665
Total revenues	7,157,167	2,033,977	665,452	482,843	-	1,869,145	164,750	851,965	13,225,299
EXPENDITURES									
Current:									
General government	4,016,098	-	-	-	-	-	671,090	3,368	4,690,555
Public works and sanitation	1,880,922	14,999	-	-	-	201,000	-	251,123	2,348,044
Public Safety	628,176	-	-	-	-	-	-	83,153	711,329
Culture and recreation	271,996	-	-	-	-	-	-	1,394	273,390
Welfare and community development	-	44,483	-	-	-	1,369,437	-	403,920	1,817,840
Claims and judgments	141,441	-	-	-	-	-	-	-	141,441
Capital outlays	257,377	526,390	831,867	-	822,066	298,708	-	343,447	3,079,856
Debt Service									
Principal	90,000	-	-	302,000	-	-	-	-	392,000
Interest	66,500	-	-	120,839	-	-	-	-	187,339
Total expenditures	7,352,510	585,872	831,867	422,839	822,066	1,869,145	671,090	1,086,405	13,641,794
Excess (deficiency) of revenues over expenditures	(195,343)	1,448,105	(166,415)	60,004	(822,066)	-	(506,340)	(234,441)	(416,495)
Other financing sources (uses)									
Proceeds from bond anticipation notes	-	-	-	-	-	-	-	530,000	530,000
Transfers in	2,578	-	72,633	-	-	-	10,396	-	85,607
Transfers out	(10,396)	-	-	(2,578)	-	-	-	(72,633)	(85,607)
Total other financing resources (uses)	(7,818)	-	72,633	(2,578)	-	-	10,396	457,367	530,000
Special items (note P)									
Property taxes - amnesty	196,555	-	-	55,275	-	-	-	-	251,830
Total special items	196,555	-	-	55,275	-	-	-	-	251,830
Net change in fund balance	(6,606)	1,448,105	(93,782)	112,701	(822,066)	-	(495,944)	222,927	365,335
Fund balance at beginning of year, as restated (note K)	81,886	2,446,449	93,804	96,265	1,405,589	-	-	58,482	4,182,474
Fund balance at end of year	\$ 75,280	\$ 3,894,554	\$ 22	\$ 208,966	\$ 583,523	\$ -	\$ (495,944)	\$ 281,408	\$ 4,547,809

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2004**

Net change in fund balances - total governmental funds: **\$ 365,335**

Amounts reported for governmental activities in the Statement of activities are different because:

Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

Expenditures for capital assets	\$ 3,079,856		
Less: current year depreciation	(698,474)	\$	2,381,382

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:	(30,316)
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Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Christmas bonus reimbursement	\$ 90,882		
Law No. 52 funds receivable	329,500		
Donated capital assets	1,400,740		
Others	21,156	\$	1,842,277

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

Puerto Rico Electric Power Authority (PREPA)-prior year	\$ (62,962)		
CRIM-prior year	(131,528)		
CRIM-current year	(71,612)		
Christmas bonus reimbursement-prior year	(77,768)	\$	(343,870)

Proceeds from bond anticipation notes is an other financing source in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:	(530,000)
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Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments (net change)	30,000
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Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

General obligation bonds and notes	\$ 362,000		
Other long term liabilities	655,715	\$	1,017,715

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:

Compensated absences	\$ (149,478)		
Unemployment debt	(25,032)		
Accrued interest (net change)	746		
Christmas bonus	(181,764)		
Others	(16,910)	\$	(372,438)

Change in net assets of governmental activities:	\$ 4,360,085
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The accompanying notes are an integral part of these statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Rincon was founded in 1770. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of twelve (12) members of the Municipal Legislature. The Municipality engages in comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

1. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality of Rincon (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and,
 - 1) The primary government can impose its will on the potential component unit and/or,
 - 2) A financial benefit/ burden exist between the primary government and the potential component unit.

There are two methods of presentation of the component unit in the financial statement:

- a. Blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances.
- b. Discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

In fiscal year 2003-2004 the Municipality adopted Statement No. 39 "*Determining Whether Certain Organizations Are Component Units - an amendment of GASB 34 Statement No. 14*". This Statement amends GASB Statement No. 14 to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as components units based on the nature and significance of their relationship with the primary government. A legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if *all* of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an *individual organization* that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

In addition, other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government.

The Statement continues the requirement in Statement No. 14 to apply professional judgment in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

Basis of presentation, measurement focus and basis of accounting

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Government-wide statements

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenditures or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users.

The Municipality reports the following major governmental funds:

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

Commonwealth Legislature Grants Fund: This fund accounts for revenue sources from grants provided by the Commonwealth's Legislature for specific purposes which include, among others, acquisition, development and improvements of capital assets.

Debt Service Fund: This fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Economic Development Administration Grant Fund: Economic Development Administration Grant Fund is used to account for the financial resources used for the construction of a capital asset.

\$1,660,000 Bond Issuance Fund: This fund is used for improvement and construction of Municipality's new city hall.

Law No. 52 Fund: This fund is used to account for payroll costs reimbursements by the Puerto Rico Department of Labor.

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets. The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when the related liability is incurred.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred, subject to the availability criteria. Revenues on intergovernmental grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met and revenue becomes available. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available.

The Municipality reports deferred revenues in the governmental funds statements which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met. (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following: 1) payments of principal and interest on general long term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) 2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Notes to Financial Statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

Required Supplementary Information

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

2. Cash, cash equivalents (unrestricted and restricted) and restricted cash with fiscal agents

Cash and cash equivalents consists of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth Legislature Resolutions is restricted since their use is limited as required by law.

Restricted cash with fiscal agent in the debt service fund consist of the undisbursed balance of property tax collections retained by the Commonwealth of Puerto Rico, which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent in the \$1,660,000 Bond Issuance fund represents the undisbursed proceeds from the \$1,660,000 bond which is maintained in a cash custodian account by the Governmental Development Bank of Puerto Rico (GDB). Restricted cash and cash equivalents of other governmental funds represent the undisbursed balance of bond anticipation notes held in custody of Rural Development.

3. Receivables and due from governmental entities

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of subsequent fiscal year.

4. Interfund receivables and payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to 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 from/to other funds".

5. Inventories

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

6. Capital assets

Capital assets of the primary government, with include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items) are reported in the governmental activities in the Statements of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The Municipality maintains a threshold level of \$1 or more for capitalizing vehicles, machinery and equipment. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

All capital assets, other than land, are depreciated using the straight-line method over the following useful lives:

<u>Description</u>	<u>Years</u>
Land improvements	20
Buildings and building improvements	20-50
Infrastructure	20-40
Vehicles, machinery and equipment	5-15

7. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

8. Deferred bond issuance costs

Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

9. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

10. Fund balances and Net Assets

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

- | | |
|---------------------------|---|
| Encumbrances: | Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received. |
| Debt Service: | Represents net assets available to finance future debt service payments. |
| Capital Projects: | Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed. |
| Other specified purposes: | Represent amounts to be used for future expenditures of Federal and Commonwealth's grants as well as funds reserved through enabling legislation passed by the government itself, to be used to finance activities other than construction or capital improvement commitments |
| Advances: | Represent the non current portion of interfund loans. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

In the government-wide statements net assets are segregated into three categories:

- Invested in capital assets, net of related debt: Consists of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
- Restricted net assets: Represents net assets (restricted assets net of related debt) that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
- Unrestricted net assets: Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

11. Interfund transactions

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

12. Risk financing

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Rincon consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-Continued

13. Use of estimates

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

14. Future adoption of accounting pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

	<u>Statement</u>	<u>To be Adopted in Fiscal year ended,</u>
40	Deposit and Investment Risk Disclosure - an amendment of GASB Statement No. 3	June 30, 2005
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	June 30, 2006
43	Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans	June 30, 2008
44	Economic Condition Reporting: The Statistical Section - an amendment of NCGA Statement No. 1	June 30, 2006
45	Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions	June 30, 2010
46	Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34	June 30, 2007

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE B- DEPOSITS

The Municipality maintains its cash deposits in commercial banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. The table presented below discloses the level of custody risk assumed by the Municipality based upon how its deposits were insured or secured with collateral at June 30, 2004:

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

The bank balances and carrying amount of deposits with financial institutions as of June 30, 2004 were as follows:

	Category			Bank balance	Carrying amount
	1	2	3		
Deposits in commercial banks	\$4,690,208	\$ -	\$ -	\$4,690,208	\$ 4,518,181
Deposits in Governmental banks	-	-	1,276,369	1,276,369	1,276,369
	<u>\$4,690,208</u>	<u>\$ -</u>	<u>\$1,276,369</u>	<u>\$5,966,577</u>	<u>\$ 5,794,550</u>

Reconciliation to government-wide statement of net assets:

	Unrestricted	Restricted	Total
Carrying amount of deposits in commercial banks	\$ 946,920	\$ 3,571,261	\$ 4,518,181
Carrying amount of deposits in governmental banks	-	1,276,369	1,276,369
	<u>\$ 946,920</u>	<u>\$ 4,847,630</u>	<u>\$ 5,794,550</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE C- DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2004 follows:

	Commonwealth Entities	Federal Government
Puerto Rico Department of Education	\$ 42,000	\$ -
Municipal Revenue Collection Center (CRIM)- property taxes amnesty (general fund)	62,493	
Municipal Revenue Collection Center (CRIM) - property taxes (debt service fund)	27,833	-
Puerto Rico Department of Treasury - Christmas Bonus Reimbursement	90,882	
Rural Development Corporation	182,358	
Office of Commissioner of Municipal Affairs - CDBG	-	471,820
Economic Development Administration-EDA	-	132,079
Public Order Code	23,369	-
Puerto Rico Department of Labor - Law No.52	329,500	
Office of Elderly Affairs	31,057	
Puerto Rico Department of Family - Child Care		42,079
Others	2,327	-
	<u>\$ 791,819</u>	<u>\$ 645,978</u>

The amounts due from Puerto Rico Department of Labor (\$329,500) and \$21,156 of Office of elderly Affairs are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards.

2. Amounts due to governmental entities as of June 30, 2004 follows:

	Commonwealth Entities
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 3,770
Puerto Rico Retirement Plan Administration	32,992
Puerto Rico General Services Administration	6,902
	<u>\$ 43,664</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE D- INTERFUND TRANSACTIONS

1. Due from/to other funds

Amounts due from to other funds represent advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Major Fund - EDA	\$ 125,605
	Major Fund - CDBG	83,646
	Major Fund – Law No. 52	495,944
	Other governmental funds – Child Care	86,043
	Other governmental funds-others	49,303
Other governmental fund - Citizens Participation Fund	Major Fund - EDA	<u>42,822</u>
Total:		<u>\$ 883,363</u>

2. Advances to other funds

Advances to other funds by the Commonwealth Legislative Grants Fund and Other Governmental Funds in the amount of \$ 699,768 represents loans to the general fund for payments of payrolls, payroll taxes and other operational expenditures in previous periods not reimbursed as of fiscal year-end.

3. Operating transfers

The \$85,607 transfers among individual funds were made for the following: (1) interest earned on cash with fiscal agents in the debt service fund which is transferred to the general fund; (2) transfers from general fund to Law No. 52 Fund to cover costs not to be reimbursed by the Puerto Rico Department of Labor and, (3) transfers between Citizens Participation Fund (included as other governmental funds) and Economic Development Administration Fund for matching purposes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE E- CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2004 is as follows:

	Balance July 1, 2003, as restated	Increases	Decreases	Balance June 30, 2004
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 2,060,618	\$ 1,043,739	\$ -	\$ 3,104,358
Construction in progress	1,961,902	2,594,479	1,603,000	2,953,380
Total capital assets not being depreciated:	4,022,520	3,638,218	1,603,000	6,057,738
Capital assets, being depreciated:				
Buildings and building improvements	7,910,030	2,180,414	-	10,090,445
Infrastructure	5,153,495	-	-	5,153,495
Vehicles, machinery and equipment	4,845,466	257,377	175,310	4,927,533
Total capital assets being depreciated	17,908,991	2,437,792	175,310	20,171,472
Less accumulated depreciation for:				
Buildings and building improvements	2,333,476	152,548	-	2,486,024
Infrastructure	2,342,258	159,518	-	2,501,776
Vehicles, machinery and equipment	2,299,035	386,409	144,994	2,540,449
Total accumulated depreciation	6,974,769	698,474	144,994	7,528,249
Total capital assets being depreciated, net	10,934,222	1,739,318	30,316	12,643,223
Governmental activities capital assets, net	<u>\$ 14,956,742</u>	<u>\$ 5,377,536</u>	<u>\$ 1,633,316</u>	<u>\$ 18,700,962</u>

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

Governmental activities:

General government	\$ 37,371
Public works and sanitation	239,220
Public safety	80,456
Culture and recreation	143,166
Welfare and community development	36,320
Education	2,423
Infrastructure	159,518

Total depreciation expense, governmental activities \$ 698,474

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE E- CAPITAL ASSETS - Continued

On September 25, 2001 the US Department of Commerce, Economic Development Administration (EDA) approved a \$1,000,000 grant to the Municipality for the construction of a Waterfront Tourism Business Center Sunset Village in the Municipality. The receipt of such grant is conditioned upon compliance with terms and conditions of a grant agreement. As required by the grant agreement, for projects involving acquisition, construction, or improvement of a building, the Municipality should agree to declare and furnish to EDA, prior to initial award disbursement, a lien, covenant, or other statement, satisfactory to EDA in form and substance of EDA's interest in the property acquired or improved in whole or in part with funds made available under this award. On December 20, 2002 the Municipality signed a deed of a voluntary mortgage in the amount of \$1,000,000 in favor of EDA over a parcel of land on which the project is located. During a 20 year term, the Municipality shall not sell, lease, mortgage or otherwise use or alienate any right to, or interest in the grant property as prohibited by the grant agreement, or use that property for any other purposes than the purposes for which the project was financed by EDA unless prior approval of the Assistant Secretary of the Department is obtained. Upon violation of applicable restrictions, the total amount will become due and payable by the Municipality to EDA.

NOTE F- LONG TERM DEBT

1. Summary of long- term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2004:

	Balance at July 1, 2003, as restated	Increases	Decreases	Balance at June 30, 2004	Due within one year
General, Special Obligations Bonds and Notes	\$ 4,261,000	-	\$ 362,000	\$ 3,899,000	\$ 393,000
Bond anticipation note	-	530,000	-	530,000	-
Note payable to CRIM-Law No. 42	470,663	-	6,092	464,571	-
Note payable to CRIM-LIMS	152,749	-	14,277	138,471	15,140
Note payable to CRIM-financing of delinquent accounts	165,479	-	23,008	142,472	60,319
Payable to CRIM- final settlement 2003- 2004	-	88,520	-	88,520	-
Payable to Puerto Rico Treasury Department - prior years property taxes	61,765	-	10,016	51,749	10,015
Payable to Puerto Rico Department of Labor- unemployment tax Compensated absences	464,188	25,032	160,033	329,186	133,361
Christmas Bonus	581,873	149,478	28,697	702,654	33,084
Judgments and legal claims	167,418	181,764	167,418	181,764	181,764
	246,173	-	246,173	-	-
	<u>\$ 6,571,308</u>	<u>\$ 974,794</u>	<u>\$ 1,017,714</u>	<u>\$ 6,528,387</u>	<u>\$ 826,683</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2004 amount to \$3,899,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).

A detail of the general and special obligation bonds and notes as of June 30, 2004 follows:

	<u>Outstanding Amount</u>
2000 special obligation bonds of \$910,000 due in annual installments of \$75,000 to \$125,000 through July 1, 2010; bearing interest at rates ranging from 5.0% to 8.0% (5.00% at June 30, 2004)	\$ 700,000
2002 special obligation bond of \$635,000 due in annual installments of \$10,000 to \$50,000 through January 1, 2027; bearing interest at 6.5%	630,000
1996 general obligation bonds of \$75,000 due in annual installments of \$10,000 through July 1, 2005; bearing interest at rates ranging from 6.5% to 8.00% (5.00% at June 30, 2004)	20,000
2001 general obligations notes of \$465,000 due in annual installments of \$95,000 to \$105,000 through July 1, 2006; bearing interest at rates ranging from 2.8% to 3.21% (2.80% at June 30, 2004)	300,000
1999 general obligation notes of \$705,000 due in annual installments of \$140,000 through January 1, 2004; bearing interest at 2.8%	140,000
1994 public improvement bond of \$721,000 due in annual installments of \$27,000 to \$52,000 through January 1, 2017; bearing interest at 5.0%	504,000
2002 general obligation bond of \$1,660,000 due in annual installments of \$30,000 to \$130,000 through July 1, 2026; bearing interest at rates ranging from 2.8% to 5.6% (2.80% at June 30, 2004)	1,605,000
	<u>\$ 3,899,000</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

The debt services requirement to amortize general and special obligation bonds and notes as of June 30, 2004 follows:

June 30	Principal	Interest
2005	\$ 393,000	\$ 186,117
2006	270,000	186,616
2007	276,000	193,947
2008	188,000	180,356
2009	194,000	147,829
2010-2014	780,000	577,267
2015-2019	613,000	408,152
2020-2024	640,000	239,717
2025-2027	545,000	39,805
Totals	<u>\$ 3,899,000</u>	<u>\$ 2,159,804</u>

3. Other long-term liabilities

	<u>Outstanding Amount</u>
<p>Bond anticipation note – During the fiscal year the Municipality issued a \$530,000 bond anticipation note (BAN) through the Governmental Development Bank of Puerto Rico (GDB) and payable to the US Department of Agriculture-Rural Development (RD), to finance the construction of a sanitary sewer system. This amount represents the Municipality's share of project cost, which will be financed with a \$ 1,586,730 grant from RD. The Municipality intends to refinance this BAN on a long term basis through a \$530,000 general obligation bond, approved by GDB on September 24, 2003. The general obligation bond will bear 4.25% interest and will be due 10 years after bond issuance.</p>	\$ 530,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

Outstanding
Amount

Note payable to CRIM (Law No. 42) – Law No. 42 of January 26, 2000 (as amended by Law No. 146 of October 11, 2001 and Law No. 172 of August 11, 2002) was enacted to authorize the CRIM to obtain a special loan in the form of a line of credit from the Governmental Development Bank of Puerto Rico (GDB) to finance a debt the municipalities of Puerto Rico own to CRIM for excess property tax advances as of June 30, 2000. Principal and interest payments are financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Amounts are retained from advances of property tax and amounts of municipal equalization fund send to the Municipality by the CRIM. Law No.42 was amended by Law no. 146 to extend from 10 to 30 years the financing period and by Law No. 172 to extend the debt period to June 30, 2001. On November 26, 2002 the Municipality entered into the financing agreement with the CRIM for a total amount of \$476,395, bearing interest at 6.18% and due on July 1, 2032. Debt service requirements in future years are as follows:

464,571

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 6,477	\$ 28,647
2006	6,882	28,260
2007	7,314	27,807
2008	7,774	27,548
2009	8,262	27,310
2010-2014	49,771	125,828
2015-2019	67,514	107,257
2020-2024	91,361	83,979
2025-2029	124,195	51,415
2030-2032	95,021	10,679
Totals	<u>\$ 464,571</u>	<u>\$ 518,730</u>

Note payable to CRIM (LIMS) - On November 28, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$172,655 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$11,578, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the CRIM. Debt service requirements in future years are as follows:

138,471

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

June 30	Principal	Interest	<u>Outstanding Amount</u>
2005	\$ 15,139	\$ 7,942	
2006	16,054	7,023	
2007	17,025	6,049	
2008	18,051	5,016	
2009	19,141	3,921	
2010-2014	53,061	4,565	
Totals	<u>\$ 138,471</u>	<u>\$ 34,517</u>	

Note payable to CRIM (Financing of delinquent accounts)– On March 27, 2002 the Municipality entered into a financing agreement with the CRIM in the amount of \$165,479 to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a nonrevolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next 25 years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first 5 years will be financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first 5 years any collection from those delinquent accounts will be credited to the loan principal. After the 5 year period the loan outstanding balance will be restructured for a 25 years period. Debt service requirements in future years are as follows:

142,471

June 30	Principal	Interest
2005	\$ 60,319	\$ 9,261
2006	-	4,910
2007	-	5,340
2008	-	5,340
2009	1,412	5,298
2010-2014	8,615	24,939
2015-2019	11,913	21,641
2020-2024	16,474	17,080
2025-2029	22,781	10,774
2030-2032	20,957	2,532
Totals	<u>\$ 142,471</u>	<u>\$ 107,115</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

	<u>Outstanding Amount</u>
<p>Payable to Puerto Rico Treasury Department, prior years property taxes - represent advances of property taxes paid in prior years to the Municipality in excess of actual property tax revenues. This amount is currently being repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the CRIM.</p>	51,749
<p>Payable to CRIM, final settlement 2003-2004 - represents the balance owed to CRIM at June 30, 2004 for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal year ended June 30, 2004 (see note H). This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the CRIM.</p>	88,520
<p>Payable to Puerto Rico Department of Labor (PRDL) – unemployment tax - represent a debt to PRDL for unemployment taxes paid by PRDL in behalf of the Municipality. Of this amount, \$133,361 is paid through a payment plan due on April 1, 2005 and financed with unrestricted funds. The remaining \$195,825 represents debt not under a payment plan. The Municipality intends to refinance this amount on a long term basis through a general obligation bond. The Municipality's Legislature is in process to enact a Municipal Ordinance to approve the refinancing agreement.</p>	329,186
<p>Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds</p>	702,654
<p>Christmas Bonus - represent the accrued portion corresponding to fiscal year 2003-2004 of the Christmas bonus to be paid in December 2004</p>	181,764

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE F- LONG TERM DEBT – Continued

4. Unused available line of credit

During fiscal year the Governmental Development Bank of Puerto Rico (GDB) approved a \$1,200,000 line of credit to the Municipality to complete the construction of the new city hall. Interest rates will be variable (LIBOR + 1.25% ranging from 5% to 12% annually) and payable each January 1 and July 1. Repayment will be made in three annual installments ending in fiscal year 2006-2007 and financed with a Commonwealth Legislature Grant (RC no. 1474 of November 9, 2003). There were no amounts outstanding under this line of credit as of June 30, 2004.

NOTE G – LANDFILL CLOSURE AND POST CLOSURE CARE COSTS OBLIGATION

The Municipality discontinued the operation and ceased to accept solid waste in its landfill. Commonwealth's and Federal laws and regulations require the Municipality to perform certain closure procedures and establish monitoring and maintenance procedures at the landfill site for thirty years after closure. The closure procedures were assumed and completed by the Municipality. The Municipality is required to provide post closure care after closure is completed. Total post closure care costs have not been determined and accounted as required by accounting principles generally accepted in the United States of America as of June 30, 2004.

NOTE H – PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st.

The tax rates in force as of June 30, 2004 are 8.53% for real property (of which 8.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.53% for personal property (of which 6.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.50% and 5.50%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.50% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE H – PROPERTY TAXES - Continued

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$ \$88,520 resulting from the final settlement for fiscal year 2003-2004. The total amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

NOTE I – MUNICIPAL LICENSE TAXES

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15.

During the fiscal year ended June 30, 2004, the tax rates were as follows:

Financial business – 1.50% of gross revenues

Other organizations - .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$ 330,057 is recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE J – INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal equalization fund and subsidy send by CRIM	\$ 3,696,405
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	818,209
Reimbursement from Commonwealth Government - Christmas Bonus expenditures	133,317
Other intergovernmental revenues	51,009
	<u>\$ 4,698,940</u>

NOTE K – FUND BALANCE RESTATEMENTS

1. Fund balances

Certain special funds with self imposed restrictions (with fund balances of \$277,540) and previously reported as special revenues and capital project funds, were reclassified to the general fund. In addition, the beginning fund balance of the General Fund and the Commonwealth Legislative Grants Fund has been restated to recognize corrections of accounting errors. The following schedule reconciles the fund balance at July 1, 2003 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments			Balance at beginning of year, as restated
	Balance at beginning of year, as previously reported	Fund reclassifications	Correction of errors	
General fund	\$ (261,508)	\$ 277,540	\$ 65,854	\$ 81,886
Commonwealth Legislative Resolutions	3,024,967	-	(578,518)	2,446,449
Economic Development Grant	93,804	-	-	93,804
Debt service	96,265	-	-	96,265
\$1,660,000 Bond Issuance	1,405,589	-	-	1,405,589
Community Development Block Grant	-	-	-	-
Law No. 52	-	-	-	-
Other governmental funds	10,078	(277,540)	325,944	58,482
Total	<u>\$ 4,369,195</u>	<u>\$ -</u>	<u>\$ (186,720)</u>	<u>\$ 4,182,474</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE K – FUND BALANCE RESTATEMENTS - Continued

2. Net assets

Net assets at beginning of year have been adjusted to reflect the following restatements:

	<u>Amount</u>
Net assets at beginning of year as previously reported:	\$ 8,533,502
Restatements:	
Net correction of errors - capital assets	5,161,850
Note payable to CRIM (LIMS) not recorded	(256,500)
Other correction of errors	(375,302)
Net assets at beginning of year as restated:	<u>\$ 13,063,550</u>

NOTE L – RETIREMENT PLAN

1. Plan description

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and non-occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. 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. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Law No. 305 of September 24, 1999 amended the Act. No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE L – RETIREMENT PLAN - continued

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will subject to the total accumulate balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions have not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.725% of gross salary.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

<u>Fiscal year ended:</u>	<u>Law No. 447</u>	<u>System 2000</u>
2004	<u>\$ 114,374</u>	<u>\$ 57,077</u>
2003	<u>\$ 114,509</u>	<u>\$ 53,814</u>
2002	<u>\$ 125,832</u>	<u>\$ 47,435</u>

NOTE M – COMMITMENTS

1. Construction

The Municipality has commitments at June 30, 2004 of approximately \$ 4,062,013 for design, construction, improvements or renovation of certain municipal facilities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE N – CONTINGENCIES

1. Federal and State Grants

Projects financed by the Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that would not be covered by insurance. However, it is the opinion of the Municipality and the legal counsel that based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

NOTE P – SPECIAL ITEMS

1. Property tax amnesty

Law No. 74 of March 1, 2004 approved by the Commonwealth's Legislature (as amended by Law No. 131 of June 1, 2004) granted to taxpayers (for the period March 1, 2004 to June 30, 2004) an amnesty for payment of real and personal property tax debts. As a result, the CRIM distributed to the Municipality \$ 251,830 on property tax collections as of June 30, 2004 of which \$196,555 were recorded in the general fund and \$ 55,275 recorded in the debt service fund. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of Municipality's management.

2. Transfer of recreational and sport facilities

During the fiscal year, the Puerto Rico Department of Recreation and Sports, a Commonwealth agency, transferred to the Municipality at no cost, the ownership of certain recreational and sports facilities (included related land), pursuant to Act No. 120 of August 17, 2001 of the Commonwealth's Legislature.

NOTE Q – FUND BALANCE DEFICIT

Law No. 52 fund disclosed a fund balance deficit of \$495,944 in the fund statements. Revenues of this fund are recorded when payrolls costs, paid in advance by the general fund, are submitted to the Puerto Rico Department of Labor (PRDL) for reimbursement. After complying with this requirement, the Municipality is eligible to recognize related revenue. The amount of \$329,500 is recognized as deferred revenue in the fund statements since amounts were billed to PRDL before June 30, 2004 but were received after applicable availability period. An additional amount of \$166,444 will be recognized as revenue in fiscal period 2004-2005 since was billed to PRDL after June 30, 2004.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE R – OPERATIONAL DEFICIT-GENERAL FUND

The statement of revenues, expenditures and changes in fund balances disclosed a negative net change in fund balance of \$6,606 in the general fund. This negative amount is due primarily by the net results of other special funds (with self imposed restrictions) included as part of the general fund. Resources to finance these special funds were provided in previous years but funds were expended in current year.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON**

**BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2004**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 1,223,312	\$ 1,664,302	\$ 1,664,302	\$ -
Municipal license tax	420,000	420,000	410,613	(9,387)
Intergovernmental	3,952,032	3,952,032	3,926,751	(25,281)
Licenses, permits and other local taxes	377,000	518,493	651,935	133,442
Fees, fines and charges for services	185,000	185,000	156,115	(28,885)
Interest	65,000	65,000	35,473	(29,527)
Rent	65,000	65,000	49,390	(15,610)
Other	120,000	143,525	169,830	26,305
Total revenues	<u>6,407,344</u>	<u>7,013,352</u>	<u>7,064,409</u>	<u>51,058</u>
EXPENDITURES:				
Current:				
General government	3,735,433	4,081,294	3,910,245	171,048
Public works and sanitation	1,651,733	1,885,253	1,883,693	1,560
Public safety	753,405	686,593	677,450	9,143
Culture and recreation	266,773	275,212	271,973	3,239
Total expenditures	<u>6,407,344</u>	<u>6,928,352</u>	<u>6,743,362</u>	<u>184,990</u>
Excess (deficiency) of revenues over (under) expenditures	-	85,000	321,048	236,048
Other financing sources (uses)				
Transfers out	-	(85,000)	(85,000)	-
Total other financing sources (uses)	-	(85,000)	(85,000)	-
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 236,048</u>	<u>\$ 236,048</u>

The accompanying notes are an integral part of this required supplementary information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RINCON
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION –
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2004

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared. Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level. The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET TO GAAP RECONCILIATION

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

	<u>Amount</u>
Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ 236,048
Budget to GAAP differences:	
Entity differences:	
Non budgeted funds recorded as revenues for financial reporting:	185,071
Non budgeted funds recorded as expenditures for financial reporting:	(546,484)
Transfers out recorded for budgetary purposes:	74,604
Basis of accounting differences:	
Revenues recorded for financial reporting but not in budgetary basis:	139,821
Revenues recorded in budgetary basis but not for financial reporting:	(33,000)
Expenditures recorded for financial reporting but not in budgetary basis:	(84,648)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary basis:	21,982
Net change in fund balance(GAAP basis):	<u>\$ (6,606)</u>

