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AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE RIO GRANDE

AUDITORIA 2003-2004

30 DE JUNIO DE 2004

05-0028-Com

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE**

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULE**

With Independent Auditors' Report Thereon
June 30, 2004

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Basic Financial Statements and
Supplemental Schedule
June 30, 2004**

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Independent Auditors' Report

The Honorable Mayor, Members of the
Municipal Legislature and People of
the Municipality of Río Grande
Río Grande, 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 Río Grande of the Commonwealth of 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 accompanying 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.

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 respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

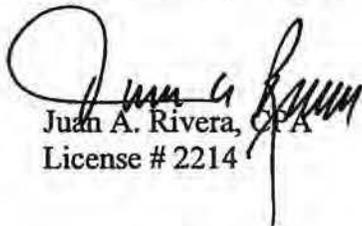
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Río Grande of the Commonwealth of Puerto Rico, as of June 30, 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 Audit Standards, we have also issued our report dated December 13, 2004 on our consideration of the Government's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Audit Standards and should be read in conjunction with this reporting in considering the results of our audit.

Our audit were performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying schedule of expenditure of federal awards is presented for purpose of additional analysis as required by US Office of Management and Budget Circular A- 133, Audit of States, Local Governments, and Non- Profit Organizations, and is not required part of the general purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

The Municipality of Rio Grande is a defendant in a lawsuit for unpaid services rendered by the plaintiff consisted of pick up and travel of debris caused by Hurricane George. The amount claimed by the plaintiff is approximately \$4,037,485. As of the date of this report there is not sufficient information to determine if such litigation will affect the municipality financial position.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule are not required parts of the basic financial statements referred to above, but are supplementary information required by GASB. 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.


Juan A. Rivera, CPA
License # 2214

December 13, 2004
Toa Baja, Puerto Rico



Stamp NO. 2010598 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

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

Management of the Municipality of Río Grande of the Commonwealth of Puerto Rico (the "Municipality") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2004, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, issued by the Governmental Accounting Standards Board (commonly known as "GASB 34"). According to this statement, significant required changes in content and structure have been made in the accompanying Municipality's basic financial statements as of and for the fiscal year ended June 30, 2004, which make the accompanying basic financial statements not easily comparable to the Municipality's general purpose financial statements issued in prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of GASB 34, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget), and;
- e) Identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality's has reported assets and net assets amounting to \$56,728,033 and \$29,969,770, respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to \$32,388,272 (57 percent of total Municipality's assets).
- The Municipality has reported total liabilities amounting to \$26,758,263 in the accompanying statement of net assets, of which the most significant liabilities are: (1) deferred revenues (\$2,925,656), (2) bonds and notes payable (\$16,827,737) and (3) accrued compensated absences (\$2,262,402). These liabilities account for 82 percent of the Municipality's total liabilities at June 30, 2004.
- The Municipality has reported total revenues amounting to \$22,540,512 in the accompanying statement of activities, of which: (1) unrestricted intergovernmental grants and reimbursements (\$3,529,383), (2) restricted capital and operating grants (\$4,375,488), (3) property taxes (\$7,297,629) and (4) construction excise taxes (\$3,324,269) were the most significant revenues amounting to \$18,526,769 (82 percent of total revenues).
- The Municipality has reported a net change in net assets (excess of revenues over expenses) amounting to \$4,868,363 in the accompanying statement of activities.

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

- The Municipality's governmental funds reported combined ending fund balances of \$14,451,883 of which \$13,109,453 (91 percent) represent the fund balances of the general fund, the CDBG fund and the debt service fund combined (jointly known as the Municipality's major funds).
- The Municipality has reported unreserved fund balance for the general fund amounting to \$6,854,967.
- The Municipality has reported a deficiency of revenues and other financing sources over expenditures and other financing uses amounting to \$(595,075) in the governmental funds.

USING THIS ANNUAL REPORT

This annual report consists of a series of new financial statements with a change in the focus from the previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedule) in addition to the basic financial statements themselves. These components are described below:

Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2004 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

Statement of Net Assets

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

Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2004. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

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

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

Fund Financial Statements

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

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

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year (June 30, 2004). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

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

For financial reporting purposes the Municipality has three major funds: (1) the general fund, (2) the CDBG fund and (3) the debt service fund.

Notes to the Basic Financial Statements

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

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

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

INFRASTRUCTURE ASSETS

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach), which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2002, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$29,969,770 at June 30, 2004.

The largest portion of the Municipality's net assets is invested in capital assets net of their related debt (\$27,400,890). The Municipality's net assets are also composed of net assets amounting to \$8,683,152 that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net assets are reported net of an unrestricted deficit of \$(6,114,272).

The unrestricted deficit is the consequence of previous budgets, which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

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

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

Condensed Statement of Net Assets:

| | |
|---|----------------------|
| Current and other assets | \$ 13,330,646 |
| Noncurrent and other assets | <u>43,397,387</u> |
| Total assets | <u>\$ 56,728,033</u> |
| | |
| Long-term liabilities outstanding | \$ 18,222,007 |
| Other liabilities | <u>8,536,256</u> |
| Total liabilities | <u>\$ 26,758,263</u> |
| | |
| Invested in capital assets, net of related debt | \$ 27,400,890 |
| Restricted | 8,683,152 |
| Unrestricted | <u>(6,114,272)</u> |
| Total net assets | <u>\$ 29,969,770</u> |

Changes in Net Assets

The Municipality's net assets increased by \$4,868,363 during the year. Approximately 58 percent of the Municipality's total revenues came from taxes, while 19 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (26 percent), public safety (19 percent) and health and sanitation (25 percent).

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

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

Condensed Statement of Activities:

| | |
|------------------------------------|----------------------|
| Revenues: | |
| Program revenues: | |
| Operating grants and contributions | \$ 1,350,789 |
| Capital grants and contributions | 3,024,699 |
| General revenues: | |
| Property taxes | 7,297,629 |
| Municipal license taxes | 2,346,971 |
| Construction excise taxes | 3,324,269 |
| Other | 5,196,155 |
| Total revenues | <u>22,540,512</u> |
| | |
| Expenses: | |
| General government | 4,642,895 |
| Public safety | 3,379,433 |
| Health and sanitation | 4,372,696 |
| Urban and economic development | 1,691,635 |
| Public housing and welfare | 2,707,279 |
| Interest | 878,211 |
| Total expenses | <u>17,672,149</u> |
| | |
| Net increase in net assets | 4,868,363 |
| | |
| Net assets - at beginning of year | <u>25,101,407</u> |
| Net assets - at end of year | <u>\$ 29,969,770</u> |

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

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

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

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

Condensed Balance Sheet - Governmental funds:

| | |
|------------------------------------|----------------------|
| Total Assets - Major Funds | \$ 21,457,154 |
| Total Assets - Nonmajor Funds | <u>3,257,722</u> |
| Total assets | <u>24,714,876</u> |
| Total Liabilities - Major Funds | 8,347,701 |
| Total Liabilities - Nonmajor Funds | <u>1,915,292</u> |
| Total liabilities | <u>10,262,993</u> |
| Fund Balances - Major Funds | 13,109,453 |
| Fund Balances - Nonmajor Funds | <u>1,342,430</u> |
| Total net assets | <u>\$ 14,451,883</u> |

Condensed Statement of Operations - Governmental funds:

| | |
|-------------------------------------|---------------------|
| Total Revenues - Major Funds | \$ 20,843,656 |
| Total Revenues - Nonmajor Funds | <u>1,972,183</u> |
| Total revenues | <u>22,815,839</u> |
| Total expenditures - Major Funds | 18,507,512 |
| Total expenditures - Nonmajor Funds | <u>4,903,402</u> |
| Total expenditures | <u>23,410,914</u> |
| Revenues Over Expenses - Major | 2,336,144 |
| Revenues Over Expenses - Nonmajor | <u>(2,931,219)</u> |
| Total excess/(deficiency) | <u>\$ (595,075)</u> |

GENERAL FUND BUDGETARY HIGHLIGHTS

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

The accompanying Budgetary Comparison Schedule shows a total negative variance between budgeted revenues and actual revenue results of \$(950,094), which was mainly caused by a negative variance of \$(2,022,188) in other revenues.

In addition, the accompanying Budgetary Comparison Schedule shows a total positive variance between budgeted expenditures and actual expenditures results of \$32,82,001.

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

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$46,630,653 of which \$16,436,335 represents infrastructure assets at June 30, 2004. The related accumulated depreciation and amortization of capital assets amounted to \$14,249,605, of which \$559,458 is related to infrastructure assets at June 30, 2004. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$4,883,460 for the year ended June 30, 2004. Depreciation and amortization charges for the year totaled \$599,208.

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

Debt Administration

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

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

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

ECONOMIC FACTORS AND NEXT BUDGETS AND RATES

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

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

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal year. There were no significant changes between the budget for fiscal year 2002-2004 and the one for fiscal year 2004-2004.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's' accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mrs. Marlene Smith Bermúdez, at PO Box 847, Río Grande, Puerto Rico, 00745.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Statement of Net Assets
June 30, 2004

ASSETS

Current Assets:

| | | | |
|--|----|------------------|-------------------|
| Cash and cash equivalents | | \$ | 6,896,538 |
| Investments in certificates of deposit | | | 209,979 |
| Receivables, net of allowance for doubtful accounts: | | | |
| Taxes: | | | |
| Property taxes | \$ | 4,968,398 | |
| Municipal license taxes | | 442,458 | |
| Total taxes receivable | | <u>5,410,856</u> | |
| Accrued interest | | 10,716 | |
| Intergovernmental | | 658,620 | |
| Other | | <u>83,321</u> | |
| Total receivables | | | 6,163,513 |
| Inventories | | | 15,580 |
| Prepaid expenses | | | <u>45,036</u> |
| Total current assets | | | <u>13,330,646</u> |

Noncurrent Assets:

| | | | |
|--|--|----|-------------------|
| Temporarily restricted cash and cash equivalents | | | 10,926,222 |
| Deferred charges, net of accumulated amortization | | | 82,893 |
| Capital assets, net of accumulated depreciation and amortization | | | <u>32,388,272</u> |
| Total noncurrent assets | | | <u>43,397,387</u> |
| Total assets | | \$ | <u>56,728,033</u> |

LIABILITIES

Current liabilities:

| | | | |
|--|--|--|----------------|
| Accounts payable and other accrued liabilities | | | 2,034,339 |
| Accrued interests on bonds, notes and obligations under capital leases | | | 426,045 |
| Intergovernmental | | | 1,226,592 |
| Deferred revenues | | | 2,925,656 |
| Reserve for federal costs disallowances, excluding long-term portion | | | 40,121 |
| Accrued compensated absences, excluding long-term portion | | | 1,202,609 |
| Obligation under capital leases, excluding long-term portion | | | 7,879 |
| Bonds and notes payable | | | <u>673,015</u> |
| Total current liabilities | | | 8,536,256 |

Noncurrent liabilities:

| | | | |
|--|--|--|-------------------|
| Accrued compensated absences, excluding current portion | | | 1,059,793 |
| Claims and judgments | | | 324,731 |
| Reserve for federal costs disallowances, excluding current portion | | | 682,761 |
| Bonds and notes payable, excluding current portion | | | <u>16,154,722</u> |
| Total noncurrent liabilities | | | <u>18,222,007</u> |
| Total liabilities | | | <u>26,758,263</u> |

NET ASSETS (DEFICIT)

| | | | |
|---|--|----------------|--------------------|
| Invested in capital assets, net of related debt | | | <u>27,400,890</u> |
| Restricted for: | | | |
| Debt service | | 7,129,345 | |
| Capital projects | | 1,059,591 | |
| Advances and long-term receivables | | 214,893 | |
| Other specified purposes | | <u>279,323</u> | |
| Total restricted net assets | | | <u>8,683,152</u> |
| Unrestricted net deficit | | | <u>(6,114,272)</u> |
| Total net assets | | \$ | 29,969,770 |
| Total Liabilities and net assets | | \$ | <u>56,728,033</u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Statement of Activities
Year Ended June 30, 2004

| Functions/Programs | Expenses | Charges for Services | Program Revenues | | Net Expenses and Changes in Net Assets |
|--|----------------------|----------------------|------------------------------------|----------------------------------|--|
| | | | Operating Grants and Contributions | Capital Grants and Contributions | |
| Governmental activities: | | | | | |
| General government | \$ 4,642,895 | \$ 91,096 | \$ 154,777 | \$ 263,433 | \$ (4,133,589) |
| Urban and economic development | 1,691,635 | | 68,193 | 2,447,130 | 823,688 |
| Public safety | 3,379,433 | | 90,758 | | (3,288,675) |
| Health and sanitation | 4,372,696 | | | | (4,372,696) |
| Public housing and welfare | 2,707,279 | | 1,037,061 | 314,136 | (1,356,082) |
| Interest on bonds, notes, capital lease obligations and long-term debt | 878,211 | | | | (878,211) |
| Total governmental activities | \$ 17,672,149 | \$ 91,096 | \$ 1,350,789 | \$ 3,024,699 | \$ (13,205,565) |
| General revenues: | | | | | |
| Taxes: | | | | | |
| | | | | | \$ 7,297,629 |
| | | | | | 2,346,971 |
| | | | | | 3,324,269 |
| | | | | | <u>12,968,869</u> |
| | | | | | 3,529,383 |
| | | | | | 162,408 |
| | | | | | 1,413,268 |
| | | | | | <u>18,073,928</u> |
| | | | | | 4,868,363 |
| | | | | | <u>25,101,407</u> |
| | | | | | <u>\$ 29,969,770</u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Balance Sheet
 Governmental Funds
 June 30, 2004

| | Major Funds | | | Other Governmental Funds | Total Governmental Funds |
|---|----------------------|----------------------|--------------|--------------------------------|--------------------------------|
| | General Fund | Debt Service Fund | CDBG Fund | | |
| ASSETS | | | | | |
| Unrestricted cash and cash equivalents | \$ 6,896,538 | \$ | \$ | \$ | \$ 6,896,538 |
| Investments in certificates of deposits | 209,979 | | | | 209,979 |
| Receivables, net of allowance for doubtful accounts: | | | | | |
| Taxes: | | | | | |
| Property taxes | 4,072,918 | 895,480 | | | 4,968,398 |
| Municipal license tax | 442,458 | | | | 442,458 |
| Accrued interest or deposits | 4,505 | 4,900 | | 1,311 | 10,716 |
| Other | 83,321 | | | | 83,321 |
| Total taxes receivable | 4,603,202 | 900,380 | | 1,311 | 5,504,893 |
| Intergovernmental, principally from the governments of the Commonwealth of Puerto Rico and United States of America | 321,660 | | | 336,960 | 658,620 |
| Advances from other funds | 214,893 | | | | 214,893 |
| Due from other funds | 153,313 | 48,875 | | 101,543 | 303,731 |
| Total receivables, net | 5,293,068 | 949,255 | | 439,814 | 6,682,137 |
| Total current assets | 12,399,585 | 949,255 | | 439,814 | 13,788,654 |
| Temporarily restricted cash and cash equivalents | 1,027,736 | 7,080,578 | | 2,817,908 | 10,926,222 |
| Total assets | <u>\$ 13,427,321</u> | <u>\$ 8,029,833</u> | <u>\$</u> | <u>\$ 3,257,722</u> | <u>\$ 24,714,876</u> |
| LIABILITIES | | | | | |
| Account payable and accrued liabilities | \$ 1,451,872 | \$ 395,134 | \$ 193,446 | \$ 82,578 | \$ 2,123,030 |
| Matured bonds due and payable | | 491,000 | | | 491,000 |
| Advances to other funds | | | | 214,893 | 214,893 |
| Due to other funds | 48,875 | 14,354 | | 240,502 | 303,731 |
| Intergovernmental | 106,868 | | | 6,143 | 113,011 |
| Deferred revenues | 4,964,739 | 680,761 | 652 | 1,371,176 | 7,017,328 |
| Total liabilities | 6,572,354 | 1,581,249 | 194,098 | 1,915,292 | 10,262,993 |
| FUND BALANCES | | | | | |
| Encumbrances | 1,951,413 | | | | 1,951,413 |
| Debt service | | 6,448,584 | | | 6,448,584 |
| Capital projects | | | (194,098) | 1,253,689 | 1,059,591 |
| Advances and long-term receivables | 214,893 | | | | 214,893 |
| Other specified purposes | | | | 88,741 | 88,741 |
| Unreserved | 4,688,661 | | | | 4,688,661 |
| Total fund balances | 6,854,967 | 6,448,584 | (194,098) | 1,342,430 | 14,451,883 |
| Total liabilities and fund balances | <u>\$ 13,427,321</u> | <u>\$ 8,029,833</u> | <u>\$</u> | <u>\$ 3,257,722</u> | <u>\$ 24,714,876</u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Statement of Revenues, Expenditures and
Changes in Fund Balances - Governmental Funds
Year Ended June 30, 2004

| | <u>Major Funds</u> | | | <u>Other Governmental Funds</u> | <u>Total Governmental Funds</u> |
|---|-------------------------|----------------------------------|----------------------|---|---|
| | <u>General Fund</u> | <u>Debt Service Fund</u> | <u>CDBG Fund</u> | | |
| REVENUES: | | | | | |
| Taxes: | | | | | |
| Property taxes | \$ 5,917,106 | \$ 1,795,769 | \$ | \$ | \$ 7,712,875 |
| Municipal license taxes | 2,171,727 | | | | 2,171,727 |
| Construction excise taxes | 3,324,269 | | | | 3,324,269 |
| Total taxes | 11,413,102 | 1,795,769 | | | 13,208,871 |
| Charges for services | 72,922 | | | 14,924 | 87,846 |
| Intergovernmental | 3,567,958 | | | | 3,567,958 |
| Grants and contributions: | | | | | |
| Federal grants and contributions | | | 2,447,130 | 1,037,424 | 3,484,554 |
| State contributions | | | | 890,934 | 890,934 |
| Interest, fines, and penalties | 77,619 | 55,862 | 26 | 28,901 | 162,408 |
| Other revenues | 1,413,268 | | | | 1,413,268 |
| Total revenues | <u>16,544,869</u> | <u>1,851,631</u> | <u>2,447,156</u> | <u>1,972,183</u> | <u>22,815,839</u> |
| EXPENDITURES: | | | | | |
| Current: | | | | | |
| General government | 4,777,512 | | | 260,249 | 5,037,761 |
| Public safety | 2,131,515 | | | 1,229,199 | 3,360,714 |
| Urban development | 1,341,250 | | 17,327 | 68,193 | 1,426,770 |
| Health and sanitation | 4,371,923 | | | | 4,371,923 |
| Public housing and welfare | 1,009,275 | | | 1,406,059 | 2,415,334 |
| Capital outlays | 683,739 | | 2,260,019 | 1,939,702 | 4,883,460 |
| Debt service: | | | | | |
| Principal | 400,730 | 638,000 | | | 1,038,730 |
| Interest on bonds and notes | 31,709 | 844,513 | | | 876,222 |
| Total expenditures | <u>14,747,653</u> | <u>1,482,513</u> | <u>2,277,346</u> | <u>4,903,402</u> | <u>23,410,914</u> |
| Deficiency of revenues under expenditures | <u>1,797,216</u> | <u>369,118</u> | <u>169,810</u> | <u>(2,931,219)</u> | <u>(595,075)</u> |
| OTHER FINANCING SOURCES (USES): | | | | | |
| Operating transfer-in from other funds | 189,763 | 77,750 | | 1,485,225 | 1,752,738 |
| Operating transfer-out to other funds | (1,558,910) | (55,849) | (104,488) | (33,491) | (1,752,738) |
| Total other financing sources (uses) | <u>(1,369,147)</u> | <u>21,901</u> | <u>(104,488)</u> | <u>1,451,734</u> | |
| EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES AND OTHER FINANCING USES | | | | | |
| | 428,069 | 391,019 | 65,322 | (1,479,485) | (595,075) |
| FUND BALANCES AT BEGINNING OF YEAR, AS RESTATED | | | | | |
| | <u>6,426,898</u> | <u>6,057,565</u> | <u>(259,420)</u> | <u>2,821,915</u> | <u>15,046,958</u> |
| FUND BALANCES AT END OF YEAR | | | | | |
| | <u>\$ 6,854,967</u> | <u>\$ 6,448,584</u> | <u>\$ (194,098)</u> | <u>\$ 1,342,430</u> | <u>\$ 14,451,883</u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Reconciliation of Statement of Revenues,
 Expenditures and Changes in Fund Balances
 Governmental Funds to the Statement of Activities
 Year Ended June 30, 2004

Amounts reported for governmental activities in the accompanying statement are different because:

| | | |
|---|----|------------------|
| Net change in fund balances as reported in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds | \$ | (595,075) |
| Governmental funds report capital outlays as expenditures. However, in the accompanying statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period. | | 4,284,252 |
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the fund financial statements. | | (275,327) |
| The issuance of long-term debt provides current financial resources to governmental funds while repayment of bond and notes principal is recorded as expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. Also, governmental funds report the effect of issuance costs, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of the three differences. | | 1,038,730 |
| In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental funds, interest expenditure is reported when due. | | (1,989) |
| 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 governmental funds. | | <u>417,772</u> |
| Net change in net assets as reported in the accompanying statement of activities | \$ | <u>4,868,363</u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Río Grande of the Commonwealth of Puerto Rico (the "Municipality") is a local government constituted in 1840 with full legislative, fiscal and administrative powers to operate as a government.

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

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

a) New Financial Reporting Model

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2004, in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below on July 1, 2002. These statements require the reporting of new financial information and restructure much of the information that governments have reported in the past. Comparability with financial statements issued prior to June 30, 2003 has been affected significantly.

According to the new financial reporting model established by GASB No. 34, the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

The RSI is information presented along with, but separate from, the Municipality's basic financial statements. RSI is composed of the management discussion and analysis (MD&A).

The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2004, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

As previously mentioned, on July 1, 2002, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 – *Accounting and Financial Reporting for Nonexchange*

COMMONWEALTH OF PUERTO RICO
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June 30, 2004

Transactions, (2) GASB Statement No. 37 – Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus, (3) GASB Statement No. 38 – Certain Financial Statement Note Disclosures and (4) GASB Interpretation No. 6 – Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements.

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

b) Financial Reporting Entity

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

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

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

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39 – *Determining Whether Certain Organizations are Component Units* (GASB No. 39). This statement provides additional guidance in determining 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. Generally, GASB No. 39 requires reporting a component unit if an organization raises and holds economic resources for the direct benefit of a governmental unit.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of June 30, 2004 nor for the year then ended.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

c) *Government-wide Financial Statements*

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

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

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

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

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2004, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

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

General government:

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of internal audit
- Department of general services
- Department of public relations

Urban and economic development:

- Department of public works
- Department of planning and development
- Department of transportation and mechanics

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Notes to Basic Financial Statements
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Department of public transportation station

Department of conservation and ornate

Department of culture and tourism

Public safety:

Department of municipal police

Department of emergency management

Health and sanitation

Department of health

Department of conservation and ornate

Department of recycling

Public housing and welfare:

Department of community affairs

Department of elderly affairs

Department of services to citizens

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

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

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

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

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

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

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

d) *Governmental Fund Financial Statements*

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (one fiscal year).

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

- **General fund** – The general fund is the Municipality's main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Special revenue funds** – The special revenue funds are nonmajor funds, as defined below, used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.
- **Debt service fund** – The debt service fund is a major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund's liabilities at June 30, if resources are available at June 30 for its payment.

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as capital leases, compensated absences, claims and judgments, notes payable to the U.S. Department of Housing and Urban Development (HUD) and the Puerto Rico Treasury Department, and federal cost disallowances, among others) are accounted for in the accompanying statement of net assets. The debt service payments of such debts are accounted for in the general fund.

- **Capital projects funds** – Capital projects funds are major and nonmajor funds, as defined below, used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Significant capital outlays

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

financed from general obligation bond proceeds are accounted for also in the capital projects funds.

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

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

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes means all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the general fund, (2) the CDBG capital project fund and (3) the debt service fund.

The CDBG program provides annual grants on a formula basis to many different types of grantees through several programs.

e) Measurement Focus and Basis of Accounting

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

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of

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the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

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

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

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

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

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

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

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

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

Governmental fund financial statements – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2004, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2004. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

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

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

Interest income is recorded when earned only if collected within 90 days after year-end since these would be considered both measurable and available.

As previously discussed, on July 1, 2003, the Municipality adopted the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), which modifies the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting and clarifies a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

Pursuant to the provisions of GASBI No. 6, expenditures and related liabilities are generally recorded in the accompanying governmental fund financial statements in the accounting period

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in which the liability is incurred, as under the accrual basis of accounting, but only to the extent that they are normally expected to be liquidated with expendable financial resources.

Modifications to the accrual basis of accounting include:

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

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

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

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

f) Stewardship, Compliance and Accountability

Budgetary Control

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

The Mayor must submit an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later

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than each May 10 and May 15, respectively. The Commissioner preliminary verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 13.

The Municipal Legislature has 10 business days, up to June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

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

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

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

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

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

Budgetary Accounting

The Municipality's annual budgets are prepared under the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

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

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

The accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2004. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2004, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

Accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

The Municipality does not legally adopt budgets for the CDBG capital project fund. The financial resources received by this fund are not subject to budgeting by the Municipality since the resources received each year from the respective grantors vary from year to year and the respective amounts are granted at their discretion.

g) *Unrestricted and Restricted Deposits*

The Municipality's deposits are composed of cash on hand and demand deposits in: (1) commercial banks, (2) the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality, and (3) the Municipal Revenue Collection Center (CRIM, by its Spanish acronyms), a governmental entity responsible for the collection of property taxes on behalf of all municipalities of Puerto Rico.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any excess is invested in money market accounts or certificates of deposit.

Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

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

Cash with fiscal agent in the general and debt service funds represent property tax collections, which are retained and restricted for the payment of the Municipality's debt service, as established by law. Cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and noninterest bearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs.

h) Unrestricted and Restricted Accounts and Notes Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2004. Major receivable balances for the governmental activities include municipal license taxes, property taxes and intergovernmental receivables.

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

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the special revenue funds).

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

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

i) Inventories and Other Current Assets

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

j) Deferred Charges

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

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k) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

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

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

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

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

| | <u>Years</u> |
|---|--------------|
| Land improvements | 20 |
| Buildings, structures and building improvements | 30 to 50 |
| Infrastructure | 20 to 50 |
| Motor vehicles | 8 |
| Furniture and fixtures | 5 to 20 |
| Machinery and equipment, excluding those held under capital leases | 5 to 20 |

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

l) Deferred Revenues

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

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30, or;
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

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

m) Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, Accounting for Compensated Absences, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2004 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of social security taxes, medicare taxes, employer contributions to the employees’ retirement systems and others).

The vacation policy of the Municipality is established by law and provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year). Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

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

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

n) Long-term Debt

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds, notes, obligation under capital leases, compensated absences, legal claims and judgments, and a reserve for federal cost disallowances.

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

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

On July 1, 2002, the Municipality adopted the provisions of APB Opinion No. 21, *Interest on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to the Puerto Rico Treasury Department. According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The notes discount is amortized over the life of the notes using the effective interest method. Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

o) Leases

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

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

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Although the Municipality is prevented legally from entering into obligations extending beyond the current year budget, most capital lease agreements entered by the Municipality contain fiscal funding clauses or a cancellation clause that makes the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have fiscal funding or cancellation clauses have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered to be remote. The Municipality's lease agreements do not include contingent rental payments or escalation clauses.

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

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

p) *Accounting for Pension Costs*

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

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

q) *Risk Management*

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in

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Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

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

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

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2004. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

r) Reservations of Fund Balances

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

- **Encumbrances** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- **Capital Projects** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- **Debt Service** – Represent fund balances available to finance future debt service payments.
- **Advances and long-term receivables** – Represent the reservation of resources set aside for long-term accounts, notes and interfund receivables, which are not considered current available financial resources.
- **Other Specified Purposes** – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

s) Interfund Activities

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

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

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

t) Use of Estimates

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

u) Future Adoption of Accounting Pronouncements

On March 27, 2003, the GASB issued its Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate, (3) investment maturity, (4) interest rate sensitivity and (5) foreign exchange exposure. The provisions of GASB No. 40 are effective for the Municipality’s fiscal year commencing on July 1, 2004.

On November 18, 2003, the GASB issued its Statement No. 42 (GASB No. 42), *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement requires governments to report the effects of capital asset impairment in their financial statements. This statement also requires all governments to account for insurance recoveries in the same manner. The provisions of GASB No. 40 are effective for the Municipality’s fiscal year commencing on July 1, 2005.

The Municipality’s management has concluded that the future adoption of GASB Statements No. 40 and 42 will not have a significant impact on the Municipality’s basic financial statements

2. DEPOSITS

The Municipality maintains its deposits of cash in the Government Development Bank for Puerto Rico (“GDB”) (a governmental bank and component unit of the Commonwealth) who serves as fiscal agent of the Municipality; and in various commercial banks located in Puerto Rico. The balances deposited in GDB are uninsured and uncollateralized. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to a maximum of \$100,000 per depositor. However, under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance provided by the FDIC. All securities pledged as collateral are held by an agent of the Secretary of the Treasury of the Commonwealth in the name of the Municipality.

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Cash, cash equivalents and investments at June 30, 2004 consist of the following:

| | <u>Included in General Fund</u> | <u>Included in Debt Service Fund</u> | <u>Included in CDBG Fund</u> | <u>Included in Other Governmental Funds</u> | <u>Total</u> |
|--|---|--|--------------------------------------|---|----------------------|
| Unrestricted cash and cash equivalents in commercial bank | \$ 6,896,538 | \$ | \$ | \$ | \$ 6,896,538 |
| Temporarily restricted cash and cash equivalents | 1,027,736 | 7,080,578 | | 2,817,908 | 10,926,222 |
| Investments in certificates of deposit | <u>209,979</u> | | | | <u>209,979</u> |
| Total | <u>\$ 8,134,253</u> | <u>\$ 7,080,578</u> | <u>\$</u> | <u>\$ 2,817,908</u> | <u>\$ 18,032,739</u> |

Cash and cash equivalents consist of demand deposits and certificates of deposit (\$4,279,875).

The Municipality's bank balance of deposits and investments with financial institutions are categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2004. Risk categories are described as follows:

- Category 1:** Insured or collateralized with securities held by the Secretary of the Treasury' agents in the Municipality's name.
- Category 2:** Collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.
- Category 3:** Uncollateralized, 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.

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The carrying amount (book balance) and the bank balance of deposits and investments with financial institutions of the Municipality at June 30, 2004 consist of the following:

| | Carrying Amount | Bank Balance |
|---------------------------------|----------------------------|-------------------------|
| Deposits in commercial banks | \$ 8,150,325 | \$ 8,866,566 |
| Deposits in governmental banks | 9,672,435 | 10,532,823 |
| Investments in commercial banks | 209,979 | 209,979 |
| Total | \$ 18,032,739 | \$ 19,609,368 |

Bank balances of deposits and investments:

| | |
|---------------------|---------------|
| Category 1 | \$ 9,076,545 |
| Category 2 | |
| Category 3 | 10,532,823 |
| Total bank balances | \$ 19,609,368 |

3. MUNICIPAL LICENSE TAXES

The Municipality is authorized by law to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Río Grande. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2004, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

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

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Total municipal license tax receivable, net of an allowance for uncollectible accounts of \$360,986, amounted to \$442,258 at June 30, 2004. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$1,951,183 at June 30, 2004.

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4. PROPERTY TAXES

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

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2004 was 6.23% (of which taxpayers pay 6.03% and 0.20% is reimbursed by the Department of Treasury). Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2003 was 8.23% (of which 8.03% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

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

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

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

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

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of

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which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.

- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.
- iii. Total property tax receivable, net of an allowance for uncollectible accounts of \$5,702,002, amounted to \$4,968,398 at June 30, 2004 (of which \$895,480 are restricted for the payment of the Municipality's debt service). Deferred property tax revenues recorded in the accompanying GWFS and GFFS amounted to \$3,010,306 at June 30, 2004, of which \$680,761 is recorded in the debt service fund.

5. INTERFUND BALANCES

On July 1, 2001 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures*, issued by the Governmental Accounting Standards Board. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2004 consisted of the following:

| | Operating Transfer from: | | | | | Total |
|-----------------------------|--------------------------|-------------------------|-----------|-----------------------------|--------------------------------------|---------------------|
| | Major Funds | | | Special Revenue Funds | Other Capital Project Funds | |
| Operating Transfers to: | General Fund | Debt Service Fund | CDBG | | | |
| Major funds: | | | | | | |
| General fund | \$ | \$ 77,750 | \$ | \$ 1,481,160 | \$ | \$ 1,558,910 |
| Debt service fund | | 55,849 | | | | 55,849 |
| CDBG | | 104,488 | | | | 104,488 |
| Nonmajor funds: | | | | | | |
| Special revenue fund | | 166 | | 3,899 | | 4,065 |
| Other capital projects fund | | 29,426 | | | | 29,426 |
| Total | \$ 189,929 | \$ 77,750 | \$ | \$ 1,485,059 | \$ | \$ 1,752,738 |

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| Due To: | Major Funds | | | | | Total |
|-----------------------------|--------------|-------------------|-----------|----------------------|-----------------------------|-------------------|
| | General Fund | Debt Service Fund | CDBG | Special Revenue Fund | Other Capital Project Funds | |
| Due From: | | | | | | |
| Major funds: | | | | | | |
| General fund | \$ | \$ 48,875 | \$ | \$ | \$ | \$ 48,875 |
| Debt service fund | | 14,354 | | | | 14,354 |
| CDBG | | | | | | |
| Nonmajor funds: | | | | | | |
| Special revenue fund | | 352,542 | | 101,543 | | 454,085 |
| Other capital projects fund | | 1,310 | | | | 1,310 |
| Total | \$ | 368,206 | \$ | 48,875 | \$ | 101,543 |
| | | | | | | \$ 518,624 |

At June 30, 2004 all amounts due to among funds are considered collectible by the Municipality's management.

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, was as follows:

| | Balance at June 30, 2003, as restated | Additions | Reclassifications | Balance at June 30, 2004 |
|--|---------------------------------------|---------------------------------------|-------------------|--------------------------|
| COST BASIS: | | | | |
| Cost basis of capital assets, not subject to depreciation and amortization: | | | | |
| Infrastructure land | \$ 14,261,935 | \$ | \$ | \$ 14,261,935 |
| Construction in progress | 3,795,844 | 4,284,187 | (3,157,253) | 4,922,778 |
| Total cost basis of capital assets, not subject to depreciation and amortization | 18,057,779 | 4,284,187 | (3,157,253) | 19,184,713 |
| Cost basis of capital assets, subject to depreciation and amortization: | | | | |
| Buildings, structures and building improvements | 12,762,386 | | 2,012,246 | 14,774,632 |
| Infrastructure | 1,029,393 | | 1,145,007 | 2,174,400 |
| Land improvements | 4,624,953 | | | 4,624,953 |
| Licensed vehicles | 3,747,316 | 528,603 | | 4,275,919 |
| Machinery and equipment | 1,460,928 | 70,670 | | 1,531,598 |
| Equipment under capital leases | 64,438 | | | 64,438 |
| Total cost basis of capital assets subject to depreciation and amortization | 23,689,414 | 599,273 | 3,157,253 | 27,445,940 |
| Total cost basis of capital assets | \$ 41,747,193 | \$ 4,883,460 | \$ 3,157,253 | \$ 46,630,653 |
| | Balance at June 30, 2003 | Depreciation and Amortization Expense | Reclassifications | Balance at June 30, 2003 |
| ACCUMULATED DEPRECIATION AND AMORTIZATION: | | | | |
| Buildings, structures and building improvements | \$ 4,733,814 | \$ 257,387 | \$ | \$ 4,991,181 |
| Infrastructure | 538,687 | 20,771 | | 559,458 |
| Land improvements | 4,590,250 | 7,332 | | 4,597,582 |
| Licensed vehicles | 3,036,211 | 210,622 | | 3,246,833 |
| Machinery and equipment | 708,412 | 81,637 | | 790,049 |
| Equipment under capital leases | 35,799 | 21,479 | | 57,278 |
| Total accumulated depreciation and amortization | 13,643,173 | 599,208 | | 14,242,381 |
| CAPITAL ASSETS, NET | \$ 28,104,020 | \$ 4,284,252 | \$ | \$ 32,388,272 |

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

| | |
|---|-----------------------|
| General government | \$ 72,346 |
| Public safety | 103,437 |
| Public housing and welfare | 181,321 |
| Health and sanitation | 773 |
| Culture, recreation and education | 73,923 |
| Urban and economic development | <u>167,408</u> |
| Total depreciation and amortization expense | \$ <u>599,208</u> |

7. EMPLOYEES RETIREMENT SYSTEM

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

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

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

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

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate

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based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

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

Funding Policy:

Contribution requirements are established by law and are as follows:

| | |
|-----------------------------------|--------------------------------------|
| Municipality | 9.275% of gross salary |
| Employees: | |
| Hired on or before March 31, 1990 | 5.775% of gross salary up to \$6,600 |
| | 8.275 of gross salary over \$6,600 |
| Hired on or after April 1, 1990 | 8.275% of gross salary |

During the fiscal year ended June 30, 2004 the employer's contributions paid by the Municipality to both retirement systems amounted to \$447,575. On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years or services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, any actuarial deficiency that may exist or arise related to the Municipality's participating employees will be assumed by the Commonwealth since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements. The expansion would extend the useful life for 10 to 15 years approximately.

8. LONG-TERM DEBT

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

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

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

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2004, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2004 was as follows:

| | <u>Balance at June 30, 2003</u> | <u>Borrowings or Additions</u> | <u>Payments or Deductions</u> | <u>Other net changes</u> | <u>Balance at June 30, 2004</u> | <u>Due Within One Year</u> |
|---|-------------------------------------|------------------------------------|-----------------------------------|------------------------------|-------------------------------------|--------------------------------|
| Bonds payables | \$ 17,210,000 | \$ | \$ (603,000) | \$ | \$ 16,607,000 | \$ 646,000 |
| Notes payable to the Puerto Rico Treasury | | | | | | |
| Department | 246,437 | | (25,700) | | 220,737 | 27,015 |
| Compensated absences | 2,146,991 | | | 115,411 | 2,262,402 | 1,202,609 |
| Claims and judgments | 392,425 | | | (67,694) | 324,731 | |
| Reserve for federal cost disallowances | 1,115,896 | | (352,515) | (40,499) | 722,882 | 40,121 |
| Obligation under capital leases | 30,393 | | (22,514) | | 7,879 | 7,879 |
| Total | <u>\$ 21,142,142</u> | <u>\$</u> | <u>\$ (1,003,729)</u> | <u>\$ 7,218</u> | <u>\$ 20,145,631</u> | <u>\$ 1,923,624</u> |

Bonds payable - The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2004 is composed of the following debts:

General Obligation Bonds:

**Outstanding
Amount**

2002 serial bonds due in annual principal installments ranging from \$65,000 to \$445,000; plus interest due in semiannual installments at variable rates (5.00% at June 30, 2004) through July, 1, 2026 \$ 4,965,000

2002 serial bonds due in annual principal installments ranging from \$115,000 to \$190,000; plus interest due in semiannual installments at variable rates (2.80% at June 30, 2004) through July, 1, 2008 815,000

2004 serial bonds due in annual principal installments ranging from \$81,000 to \$366,000; plus interest due in semiannual installments at variable rates (5.00% at June 30, 2004) through July, 1, 2027 4,665,000

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| | |
|---|------------|
| 2004 serial bonds due in annual principal installments ranging from \$20,000 to \$95,000; plus interest due in semiannually installments at variable rates (5.00% at June 30, 2004) through July, 1, 2027 | 1,155,000 |
| Total general obligation bonds | 11,600,000 |

Public Improvement Bonds:

| | |
|---|--------|
| 1991 serial bonds due in annual principal installments ranging from \$5,000 to \$20,000; plus interest due in semiannually installments at variable rates (6.26% at June 30, 2004) through July 1, 2005 | 35,000 |
|---|--------|

| | |
|--|---------|
| 1996 serial bonds due in annual principal installments ranging from \$25,000 to \$91,000; plus interest due in annual installments at a 4.50% through January, 1, 2019 | 937,000 |
|--|---------|

| | |
|--|---------|
| 1997 serial bonds due in annual principal installments ranging from \$15,000 to \$90,000; plus interest due in semiannually installments at variable rates (5.80% at June 30, 2004) through July 1, 2020 | 890,000 |
|--|---------|

| | |
|---|-----------|
| 1997 serial bonds due in annual principal installments ranging from \$20,000 to \$150,000; plus interest due in semiannually installments at variable rates (5.80% at June 30, 2004) through July 1, 2020 | 1,475,000 |
|---|-----------|

| | |
|---|---------|
| 1998 serial bonds due in annual principal installments ranging from \$10,000 to \$40,000; plus interest due in semiannual installments at variable rates (5.29% at June 30, 2004) through July, 1, 2012 | 260,000 |
|---|---------|

| | |
|---|---------|
| 1999 serial bonds due in annual principal installments ranging from \$85,600 to \$115,000; plus interest due in annual installments at 4.75% through January, 1, 2005 | 115,000 |
|---|---------|

| | |
|---|-----------|
| 2002 serial bonds due in annual principal installments ranging from \$50,000 to \$155,000; plus interest due in semiannual installments at variable rates (2.870% at June 30, 2004) through July, 1, 2016 | 1,295,000 |
|---|-----------|

| | |
|--------------------------------|-----------|
| Total public improvement bonds | 5,007,000 |
|--------------------------------|-----------|

| | |
|-------------------------------|---------------|
| Total bonds and notes payable | \$ 16,607,000 |
|-------------------------------|---------------|

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These bonds are payable from the ad valorem property tax of 1.67% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

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

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

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

| Year Ended June 30, | Principal | Interest | Total |
|--------------------------------|-------------------|-------------------|-------------------|
| 2005 | 646,000 | 1,061,769 | 1,707,769 |
| 2006 | 579,000 | 1,028,225 | 1,607,225 |
| 2007 | 597,000 | 997,970 | 1,594,970 |
| 2008 | 647,000 | 965,188 | 1,612,188 |
| 2009 | 691,000 | 928,967 | 1,619,967 |
| 2010-2014 | 3,108,000 | 4,091,069 | 7,199,069 |
| 2015-2019 | 3,889,000 | 2,962,243 | 6,851,243 |
| 2020-2024 | 3,547,000 | 1,657,654 | 5,204,654 |
| 2025-2029 | 2,903,000 | 381,290 | 3,284,290 |
| Totals | 16,607,000 | 14,074,375 | 30,681,375 |

As described in Note 5, the Municipality levies an annual additional special tax of 1.75% of the assessed value of personal and real property. The proceeds of this additional special tax are required to be credited to the debt service fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected by CRIM as agent of the Municipality.

Notes payable to Puerto Rico Treasury Department – The Municipality entered into a financing agreement of \$270,886 with the Puerto Rico Treasury Department (Treasury Department) through 2011. The financing agreement allows for the financing of a debt that the Municipality has from the final settlements of property tax advances versus actual collections through fiscal year 1992. The note is payable with monthly installments of \$3,120, at no interest. At June 30, 2004, the principal balance (present value) of the note amounted to \$220,737.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

Federal cost disallowances – At June 30, 2004, the accompanying statement of net assets presents a reserve for ineligible and unsupported costs under federally assisted programs amounting to \$722,882.

Legal claims and judgments – At June 30, 2004, the accompanying statement of net assets presents a reserve for legal claims and judgments for awarded and anticipated unfavorable judgments of \$324,731.

Compensated absences – At June 30, 2004, the liability for compensated absences is \$2,262,402 of which 1,202,609 is due within one year.

9. CAPITAL LEASES

The Municipality has entered into various capital lease agreements to finance the acquisition of office equipment will expire at different years until 2008. These lease agreements qualify as capital leases for financial accounting purposes and, therefore, have been recorded at the present value of their future minimum lease payments as of the inception date. At June 30, 2004, the capitalized assets amounting to approximately \$64,438 are reported as equipment in the statement of net assets.

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2004 is as follows:

| <u>Year ending June, 30</u> | <u>Principal</u> |
|--|------------------|
| 2005 | \$ 8,000 |
| Less: Amount representing future interest payments | <u>(121)</u> |
| Current portion obligation under capital leases | <u>7,879</u> |

10. COMMITMENTS AND CONTINGENCIES

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgment.

With respects to pending or threatened litigation, the Municipality has reported liabilities of \$324,731 for awarded and anticipated unfavorable judgments as of June 30, 2004. This amount was reported within claims and judgments liabilities in the government-wide statement of net assets. Management believes that the ultimately liability in excess of amounts provided, if any, would not be significant.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Basic Financial Statements
June 30, 2004

11. ACCOUNTING CHANGES AND RESTATEMENTS

The following schedule reconciles the June 30, 2003 fund balances as previously reported by the Municipality to the beginning fund balances, as restated:

| | June 30, 2003, fund balance as previously reported | Correction of accounting errors | June 30, 2003, fund balance as restated |
|-----------------------------|---|--|--|
| Major funds: | | | |
| General fund | \$ 6,346,899 | \$ 79,999 | \$ 6,426,898 |
| Debt service fund | 6,057,721 | (156) | 6,057,565 |
| CDBG fund | (248,705) | (10,715) | (259,420) |
| Total major funds | <u>12,155,915</u> | <u>69,128</u> | <u>12,225,043</u> |
| Nonmajor funds: | | | |
| Special revenue funds | 462,991 | (432,038) | 30,953 |
| Other capital project funds | 3,363,140 | (572,178) | 2,790,962 |
| Total nonmajor funds | <u>3,826,131</u> | <u>(1,004,216)</u> | <u>2,821,915</u> |
| Total | <u>\$ 15,982,046</u> | <u>\$ (935,088)</u> | <u>\$ 15,046,958</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Budgetary Comparison Schedule
 Year Ended June 30, 2004

| | <u>Budgeted Amounts</u> | | Actual Amounts (Budgetary Basis) (See Note 1) | Variance With Final Final Budget - Positive (Negative) |
|--|-------------------------|----------------------|--|---|
| | <u>Original</u> | <u>Final</u> | | |
| Revenues: | | | | |
| Property taxes | \$ 5,046,792 | \$ 5,171,323 | \$ 6,082,095 | \$ 910,772 |
| Municipal license taxes | 2,225,000 | 2,225,000 | 2,168,333 | (56,667) |
| Construction excise taxes | 2,000,000 | 2,000,000 | 3,324,269 | 1,324,269 |
| Charges for services and rents | 56,000 | 56,000 | 65,042 | 9,042 |
| Intergovernmental grants and contributions | 3,587,641 | 3,619,641 | 2,351,058 | (1,268,583) |
| Interest on deposits | 200,000 | 200,000 | 163,498 | (36,502) |
| Miscellaneous | 799,831 | 2,790,369 | 768,181 | (2,022,188) |
| Transfers from other funds | | | 189,763 | 189,763 |
| | <u>\$ 13,915,264</u> | <u>\$ 16,062,333</u> | <u>\$ 15,112,239</u> | <u>\$ (950,094)</u> |
| Expenditures: | | | | |
| General government | \$ 5,591,840 | \$ 5,640,043 | \$ 1,978,042 | \$ 3,662,001 |
| Urban and economic development | 1,231,527 | 1,672,330 | 1,341,250 | 331,080 |
| Public safety | 2,132,095 | 2,257,778 | 2,131,514 | 126,264 |
| Public housing and welfare | 1,021,040 | 1,109,298 | 1,009,275 | 100,023 |
| Health and sanitation | 3,938,762 | 4,112,607 | 3,491,064 | 621,543 |
| Capital outlays | | 837,838 | 837,838 | |
| Debt service - principal | | 400,730 | 400,730 | |
| Debt service - interest | | 31,709 | 31,709 | |
| Transfers to other funds | | | 1,558,910 | (1,558,910) |
| | <u>\$ 13,915,264</u> | <u>\$ 16,062,333</u> | <u>\$ 12,780,332</u> | <u>\$ 3,282,001</u> |
| Explanation of Differences: | | | | |
| Sources/inflows of financial resources: | | | | |
| Actual amounts (budgetary basis) "available for appropriations" from budgetary comparison schedule | | | | \$ 15,112,239 |
| Differences - budget basis to GAAP: | | | | |
| Differences in assets and liabilities resulting from modified accrual basis of accounting in comparison with budgetary basis | | | | 1,622,393 |
| Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting | | | | (189,763) |
| Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - general fund | | | | <u>\$ 16,544,869</u> |
| Uses/outflows of financial resources: | | | | |
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | | | | \$ 12,780,332 |
| Differences - budget basis to GAAP: | | | | |
| Transfers to other funds are outflows of budgetary resources | | | | (1,558,910) |
| Differences in assets and liabilities resulting from modified accrual basis of accounting in comparison with budgetary basis | | | | 4,329,438 |
| Prior-year encumbrances recorded as current year expenditures for GAAP basis | | | | 1,148,206 |
| Current-year encumbrances recorded as expenditures for budgetary purposes | | | | (1,951,413) |
| Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds | | | | <u>\$ 14,747,653</u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2004

| FEDERAL GRANTOR/PROGRAM TITLE | FEDERAL CFDA NUMBER | EXPENDITURES |
|---|------------------------------------|----------------------------|
| US DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT | | |
| Direct Programs: | | |
| Housing Choice Voucher | 14.871 | \$ 593,275 |
| Community Development Block Grant Entitlement Grant | 14.218 | <u>2,381,860</u> |
| Total US Department of Housing and Urban Development | | <u>2,975,135</u> |
| US DEPARTMENT OF HEALTH AND HUMAN SERVICE | | |
| Indirect Program: | | |
| Pass-through the Family and Education Department Child Care and Development Block Grant | 93.575 | 153,493 |
| Pass-through the Puerto Rico Elderly Commission Special programs for Aging Title III, Part B, Grants for Supportive Services and Senior Centers | 93.044 | <u>81,903</u> |
| Total US Department of Health and Human Services | | <u>235,396</u> |
| US DEPARTMENT OF THE INTERIOR | | |
| Direct Program: | | |
| Wildlife Restoration | 15.611 | <u>31,960</u> |
| Total US Department of the Interior | | <u>31,960</u> |
| US DEPARTMENT OF AGRICULTURE | | |
| Direct Program: | | |
| Rural Housing Preservation Grant | 10.433 | <u>43</u> |
| Total US Department of the Interior | | <u>43</u> |
| US FEDERAL EMERGENCY MANAGEMENT AGENCY PUBLIC ASSISTANCE GRANT (FEMA) | | |
| Direct Program: | | |
| Public Assistance Grants | 83.544 | <u>68,193</u> |
| Total US Federal Emergency Management Agency | | <u>68,193</u> |
| TOTAL FEDERAL FINANCIAL ASSISTANCE | | <u><u>\$ 3,310,727</u></u> |

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Notes to Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2004

1. GENERAL

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

2. BASIS OF ACCOUNTING

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



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

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

Compliance

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

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

As described in item Section III in the accompanying schedule of findings and questioned costs, the Municipality of Río Grande did not comply with requirements regarding administrative requirements that are applicable to its Section 8 Program and CDBG Program. Compliance with such requirements is necessary, in our opinion, for the Municipality of Río Grande to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality of Río Grande complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004.

Internal Control Over Compliance

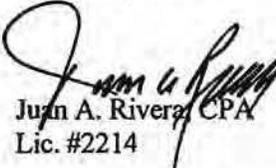
The management of the Municipality of Río Grande is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable

to federal programs. In planning and performing our audit, we considered the Municipality of Río Grande 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 the internal control over compliance in accordance with OMB Circular A-133.

Our noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality of Río Grande 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 in Section II and III.

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

However, we believe that none of the reportable conditions described above is a material weakness. This report is intended for the information of the audit committee, the Municipality's management, the Department of Housing and Urban Development (Cognizant Agency), and federal awarding agencies and pass-through entities. However, this report is not intended to be and should not be used by anyone other than these specified parties.


Juan A. Rivera, CPA
Lic. #2214

December 13, 2004
Toa Baja, Puerto Rico



NOTE: Stamp No. 2010599 Puerto Rico State Society of Certified Public Accountants was affixed to the original report.

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

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

We have audited the financial statements of the Municipality of Río Grande as of and for the year ended June 30, 2004, and have issued our report thereon dated December 13, 2004. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

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

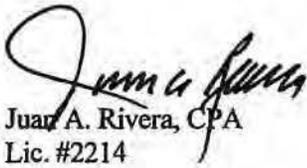
Internal Control Over Financial Reporting

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

However, we noted certain matters involving the 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 of Río Grande 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 Section II.

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

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


Juan A. Rivera, CPA
Lic. #2214

December 13, 2004
Toa Baja, Puerto Rico



Stamp NO. 2010600 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2004

Section II – Schedule of Financial Statements Findings and Questioned Costs

FINDING NUMBER 04-01

Personnel

Condition In our internal control system revision of the personnel files, the following exception was encountered:

| | | |
|--|-------|------|
| ➤ Missing documents | | |
| Employees do not have all agencies certifications | 15/15 | 100% |
| Health Certificate | 4/15 | 27% |
| Assistance Cards | 1/15 | 6% |
| Good Standing Certificate | 2/15 | 13% |
| Unsigned job application | 1/15 | 6% |
| Retention Form 499-R | 1/15 | 6% |
| ➤ Documents without the required sign | | |
| Form I-9 | 1/15 | 6% |
| ➤ Accumulative cards for salaries and deductions are not updated | 8/15 | 53% |
| ➤ The human resources office does not evaluate employees yearly | 12/15 | 80% |

Criteria

As established in the Autonomus Municipalities' Law # 81, Chapter 223, § 4557, employees shall comply with the following requirements:

- Phisically and mentally competent
- United States citizen
- Not use drugs and alcoholic beverage
- Not bring false information
- Has not been incompetent by destitution
- Has not been committed illegal acts and shame conducts
- And other elements that the Municipality consider

To obtain assurance of the compliance with those requirements the § 4572 sustain that the Municipality will keep a file with all information about its employees.

The Municipality should implement an evaluation system of the performance of its employees as establish in the § 4560 of the Autonomus Municipalities' Law.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2004

FINDING NUMBER 04-01

Personnel-(Cont.)

Cause Not request sufficient information that would suggest that everything is in accordance with the Autonomous Municipalities' Law.

Effect You could be dealing with employees who are not meeting the requirements stated by law.

Recommendation Do a purge of all personnel files, regardless of the year, in order to evidence employee's good standing.

FINDING NUMBER 04-02

Disbursement Test

Condition In our test of the vouchers to observed the compliance with good disbursement procedures we discovered the following: N/A

- Missing documents

Checking Account, elderly and child care education

| | | |
|------------------|------|----|
| Reciept evidence | 2/31 | 6% |
|------------------|------|----|

Criteria Good internal control requires that each voucher must have the information and the documents necessary to support the disbursement and the preinterventor must verified the completeness as establish in the Municipalities' regulation # 5262 § IV-7.

Cause The documents necessary are not being requested and the information in the vouchers and purchase order has been completed partially.

Effect The documents are incompletes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-02
Disbursement Test-(Cont.)

Recommendation

Follow the procedures necessary to attach all the information require to have a good internal control and to comply with the regulation.

FINDING NUMBER 04-03
Accounting and Reporting
System

Sistema

Condition

During the performance of our audit procedures the following exceptions were noted:

- a. The Municipality's accounting system provides only for the recording of revenues, expenditures and other limited transactions. In addition, the accounting records are not integrated and do not provide for, a self balancing set of accounts for each fund operated by the Municipality, recording cash and other financial resources, together with all related assets, liabilities and residual equities or balances, and changes therein. Additionally, we noted that certain records in use were not adequately maintained.
- b. Accounting records do not provide for segregation between expenditures and encumbrances.

Criteria

A municipality's accounting system must make it possible to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with accounting principles generally accepted in the United States of America and determine and demonstrate compliance with finance, legal and contractual provisions as established in the Autonomous Municipalities' Law Chapter 215§ 4360.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-03
Accounting and Reporting
System-(Cont.)

Cause

The Municipality of Río Grande has not established the accounting procedures, controls and records necessary to provide accurate information to prepare the financial statements and federal reports in conformity with accounting principles generally accepted in the United States of America, the governmental accounting and financial reporting principles issued by the Governmental Accounting Standards Board (GASB), and the related grant agreements.

Effect

Due to the deficiencies mentioned above, the examination of the general-purpose financial statements for the year ended June 30, 2004, was more difficult and less efficient than would have been in ordinary circumstances. Since the accounts and other records are not designed to provide the information as it is presented in the financial statements, was necessary to obtain such information from various departments and persons within the Municipality and from numerous accounting records, which are not integrated. This situation can cause the financial statements not to present all the assets, liabilities, revenues and expenditures of the Municipality.

Recommendation

In order to streamline the accounting and reporting systems and provide proper closing of records and adequate and timely information, we recommend the Municipality to consider the acquisition of new accounting systems.

The Municipality should implement a new accounting system that allows the preparation of monthly and year-end financial statements in accordance with accounting principles generally accepted in the United States of America applicable to government entities. This plan should provide for the following:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-03
Accounting and Reporting
System-(Cont.)

- a. Adequate training to all accounting personnel in order to improve the understanding of the system.
- b. The implementation of a double entry accounting system and the integration of all subsidiary ledgers.
- c. The preparation of periodic financial reports to be submitted to the Finance Director, the Mayor and the Municipal Assembly.
- d. Reconciliation of financial with the reports prepared and submitted to the Federal government, and The preparation of the general purpose financial statements in accordance to Accounting principles generally accepted in the United State of America.

FINDING NUMBER 04-04
Bank Accounts and Cash
Management

Condition

The following control deficiencies in bank reconciliation process were noted:

- a. Some accounts were not reconciled during the fiscal year.-2/57

Criteria

The Municipality must maintain adequate controls as require in the Autonomous Municipalities' Law Chapter 215 § 4360 in order to produce reliable information to be use as basis in the preparation and justification of the budget needs.

Cause

The Municipality has not been reconciliated some bank accounts.

Effect

The process required for bank account reconciliation and supervision might cause error or irregularities and not be timely detected.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2004

FINDING NUMBER 04-04

Bank Accounts and Cash Management-(Cont.)

Recommendation

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

FINDING NUMBER 04-05

Volume of Business Tax

Condition

During of the Volume of Business Tax (Patente) test we noted the following exception:

➤ Missing documents

| | | |
|---------------------------|------|-----|
| Tax extension | 5/15 | 33% |
| Collectors' receipts | 3/15 | 20% |
| Volume of tax declaration | 1/15 | 6% |

➤ Others

| | | |
|--|------|-----|
| Collectors do not take the oath | 9/15 | 60% |
| Volume of tax declaration not signed by the tax payer | 2/15 | 13% |
| Volume of tax form not dated | 1/15 | 6% |
| Wrong calculation of tax | 1/15 | 6% |
| Collectors' receipt altered | 1/15 | 6% |
| Volume of tax form not amended with the tax gave by the taxpayer | 1/15 | 6% |

Criteria

To a volume of business tax declaration be sufficient for all legal purposes the Autonomous Municipalities' Law, Chapter 71 § 652l, establish that it should be signed by the Finance Director or any employee of the Municipality Collection Department as describe in § 652m.

Every taxpayer should submit the volume of business declaration or request an exception, if apply. (Municipalities' Regulation #5262 § IX-6)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-05
Volume of Business Tax-(Cont.)

The taxpayer must sign the volume of business declaration in order to certificate that the volume of business is correct. (Municipalities' Regulation #5262 § IX-7)

The collector must keep two copies of the receipt and one of them is use as evidence of the payment to be located in the taxpayer file. (Municipalities' Regulation #5262 § IX-12)

In order to maintain a good internal control the Municipality should verify that all information is correct and to be alert to collect the correct amount from the taxpayer.

Cause Fail to follow the procedures established the Autonomous Municipalities' Law #81, Municipalities' Regulation #5262 and a good internal control.

Effect The volume of business tax received was not properly documented and there is no legal base without oath.

Recommendation The Municipality must establish the necessary procedures to comply with the law, regulation, and internal control mentioned above. Also the Municipality must establish a system to recognize the volume of business tax certification with the taxpayer to make easily the way to find documents.

FINDING NUMBER 04-06
Revenues

Condition During the test of the Municipality revenues we noted the following deficiencies:

- The report provided by the municipality does not have record the revenues 5/10 50%
- The municipality does not deposit revenues within the 48 hours as required by law 1/10 10%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2004

FINDING NUMBER 04-06

Revenues-(Cont.)

| | |
|-----------------------|---|
| Criteria | The Autonomous Municipalities' Law Chapter 215 § 4360, established that the procedures for public funds receipts and deposit should have the adequate and sufficient controls to avoid and to difficult irregularities. |
| Cause | Controls over the receipts and deposits of revenues are not complimented and the system does not provide reliable information. |
| Effect | Irregularities in the record and deposit of revenues. |
| Recommendation | The Municipality must establish the necessary procedures to comply with the law referred above. |

FINDING NUMBER 04-07

Contracts

Condition During the test of contracts we noted the following deficiencies:

| | | |
|--|---|--|
| <ul style="list-style-type: none"> ➤ Contract late registration in OCPR ➤ No reference were made to the maximum amount to be paid ➤ The contracts does not establish the following: <ul style="list-style-type: none"> The account to be committed has budget balance Clause of interest conflict Clause about no pecuniary interest Certification of tax negative Evidence about municipal tax paid Clause about contract termination Detail of hours worked Submit reports about labor did | <p>6/10</p> <p>2/10</p> <p>3/10</p> <p>2/10</p> <p>2/10</p> <p>2/10</p> <p>2/10</p> <p>2/10</p> <p>2/10</p> <p>1/10</p> | <p>60%</p> <p>20%</p> <p>30%</p> <p>20%</p> <p>20%</p> <p>20%</p> <p>20%</p> <p>20%</p> <p>10%</p> |
|--|---|--|

Criteria The Municipality must comply with of the Puerto Rico's Comptroller Office Circular in accordance with the requirements for contracts and the clause to be established in them.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-07
Contracts- (Cont.)

| | |
|-----------------------|---|
| Cause | The contracts do not establish the clauses requires Puerto Rico's Comptroller Office Circular and the contract settle in the Puerto Rico's Comptroller Office are late. |
| Effect | The Municipality may not have legal base against contractors because contracts are incomplete and do not protect the Municipality's economic interest. |
| Recommendation | The Municipality's Secretary must review all the contract to ensure the completeness of them and encourage the promptly settle of contracts. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

III. Federal Awards Findings and Questioned Costs

Compliance findings:

Our examination of compliance with federal requirements for the Municipality of Rio Grande for the year ended June 30, 2004, disclosed that grants funds were generally administered in a satisfactory manner, except for the following situations:

Housing Choice Voucher Program- CFDA 14.871

Documents and information required in the Municipality Administrative Plan (voucher program) met all requirements except for the following:

FINDING NUMBER 04-08

Schedule of Utility

| | |
|-----------------------|--|
| Condition | The files were incomplete due to the lack of schedule of utility. |
| Criteria | HUD reference 24 CFR 982.517 requires that an updated utility allowance schedule with data be obtained within 12 months. |
| Cause | Section 8 Housing should check changes in utility fees within 12 months. There were files that were without change for many years. |
| Effect | The Municipality does not compliance with HUD regulations. |
| Recommendation | All files for tenants should be revised annually to insure that changes in utilities were kept and if there are no changes, a new calculation sheet should be made in the calculation of rent for the period mentioned above. For people who have more than one file, a copy of the schedule should be kept in the most recent file. |

COMMONWEALTH OF PUERTO RICO
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Year Ended June 30, 2004

FINDING NUMBER 04-09

Office Conditions

| | |
|-----------------------|---|
| Condition | Section 8 offices have filtration problems and when it rains, it is impossible for people to enter the building. There is no access for disable people to the Section 8 office. |
| Criteria | ADA Law requires that Section 8 offices must be accessible, in good condition and have privacy in order to be able to assist people. |
| Cause | The roof of the building where is located the Section 8 office has leakage problems. There is no a disable people ramp for access to the Section 8 office. |
| Effect | In rainy days the office got flooded and is not accessible for the people. The equally opportunity to people who wants to participate in the Section 8 program has been violated. |
| Recommendation | Contact municipal offices in charge of repairing the problem in order for the same to be carried out as soon as possible. |

FINDING NUMBER 04-10

Cash Management

| | |
|------------------|--|
| Condition | The Section 8 Program has a large balance in its bank account as of the fiscal year ended June 30, 2004. |
| Criteria | The 24 CFR Part 985.156,157,158; Part 5, Subpart H, Part 44 HUD Handbook 7420.6 and 7420.10G Chapter 20 of the Housing Voucher Program Guide Book establish that 90 days before the fiscal year ended the Municipality should submit Form 52663 when the amount of advances are in excess of five percent of the annual contributions required for the current budget. Also the Municipality should invest the five percent of the annual contribution in a HUD interest bearing accounts and report interest in Form 52681. |
| Cause | The Municipality is not paying all the vouchers approved in the proposal submitted to Housing and Urban Development Agency. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
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Year Ended June 30, 2004

FINDING NUMBER 04-10
Cash Management-(Cont.)

| | |
|-----------------------|--|
| Effect | The Municipality does not comply with the law referred above. |
| Recommendation | Comment this problem with HUD office about the amount in the Section 8 bank account and request a solution for this situation. |

FINDING NUMBER 04-11
High Quality Standars

| | |
|-----------------------|--|
| Condition | During the audit we observed that the written procedures of housing quality standards (HQS) exist but not implemented followed and there are people living in houses that fail the inspection. |
| Criteria | Code of Federal Regulation requires (24 CFR 982.404) that any cited life-threatening HQS deficiencies are corrected within 24 hours from the inspection and all the other cited deficiencies are corrected within no more than 30 calendar days from the inspection or any PHA-approved extension. |
| Cause | The Municipality does not give the proper attention of HQS procedures to comply with federal regulations. |
| Effect | The Municipality does not have the assurance that the units are secure and comply with the standards of safe place. |
| Recommendation | The Municipality should improve the HQS procedures in order to comply with federal regulations. |

FINDING NUMBER 04-12
Tenants Files

| | |
|------------------|---|
| Condition | The form 50058 was not in the tenant file. |
| Criteria | The Circular A-133 requires that the program implement good internal controls and as established procedure of the program the Form 50058 should be completed. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-12
Tenants Files-(Cont.)

| | |
|-----------------------|--|
| Cause | The Form 50058 has not been put in the file. |
| Effect | The tenant file is incomplete and do not comply with the requirement. |
| Recommendation | The Municipality should purge all participants file in order to have filed the Form 50058. |

FINDING NUMBER 04-13
Documents for Tenants
Qualification

| | |
|-----------------------|--|
| Condition | The tenant files have various missing documents like: <ul style="list-style-type: none">• Good behavior certificate-5/15• Address evidence-3/15• Family photo-3/15• Social security-2/15• Birth certificate-2/15 |
| Criteria | The Circular A-133 requires that the program implement good internal controls. |
| Cause | The information requested has not been put in the file or not has been given by tenants. |
| Effect | The Municipality may give the benefits of the program to people do not qualify. |
| Recommendation | The Municipality should update the file with the documents necessary for comply with internal controls of tenants qualification. |

COMMONWEALTH OF PUERTO RICO
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Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-14
Commingling of Funds

| | |
|-----------------------|---|
| Condition | During the audit we observed that the Section 8 program disbursed funds to pay HOPWA program expenses. |
| Criteria | The OMB A-87 establish that any cost allocable to a particular Federal Award or Cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restriction imposed by law or terms of the Federal awards, or for other reasons. |
| Cause | The Section 8 programs pay the expenses of HOPWA because "Consortio San Juan" who is the pass through entity works by reimbursement. |
| Effect | The Municipality violates the OMB A-87. |
| Recommendation | The Municipality should use the general fund to cover the expenses of HOPWA and never use others Federal fund. |

Community Development Block Grant/ Entitlement Program- CFDA 14.218
Documents and information required except for the following:

FINDING NUMBER 04-15
Disbursement

| | |
|------------------|--|
| Condition | During the disbursement test we observed the following exception: <ul style="list-style-type: none">• Voucher for payment does not has the date when the check was made. -1/10• Vouchers for payment do not have the purchase order number-8/10 |
| Criteria | The Circular A-133 requires that the program implement good internal controls. |
| Cause | Fail to follow the procedures to comply with good internal control. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

FINDING NUMBER 04-15
Disbursement-(Cont.)

Effect Documents accompanying the disbursements are incomplete and may pay incorrectly.

Recommendation Maintain the documents required to support the disbursement in file and follow the procedures to have a good internal control.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Schedule of Prior Year Findings and Questioned Costs
 Year Ended June 30, 2004

FINDING
NUMBER 03-01
Personnel

Condition:
 Personnel files with the following missing documents:

- Unsigned job application
- Good Standing
- Controlled Substance Policy
- Ethics Law

Status

 Partially
 Corrected

FINDING
NUMBER 03-02
**Disbursement
 Test**

Condition:
 No cancellation of documents:
 Municipal Checking Account

- Does not have paid stamp
- No preintervention orders

HPG, OCAM, CDBG

- Does not have paid stamp

Partially
 Corrected

FINDING
NUMBER 03-03
**Accounting and
 Reporting
 System**

Condition

- The Municipality's accounting system provides only for the recording of revenues, expenditures and other limited transactions. Additionally, we noted that certain records in use were not adequately maintained. Accounting records do not provide for segregation between expenditures and encumbrances. There are no established procedures by the Municipality for the imposition and collection of administrative fines.
- There are no adequate accounting controls and accountability for assets, in order to ascertain the amount of the Municipality's general fixed assets.

Still
 Prevail

 Corrected

FINDING
NUMBER 03-04
**Bank Accounts
 and Cash
 Management**

Condition:
 Reconciling items are not promptly investigated and unrecognized differences are accumulated month after month. The cash transactions report (Form 4-A) is not consistently prepared on a monthly basis.

Corrected

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF RÍO GRANDE
 Schedule of Prior Year Findings and Questioned Costs
 Year Ended June 30, 2004

| <u>FINDING</u> | | <u>Status</u> |
|--|---|------------------------|
| <u>NUMBER 03-05</u> Revenues/ Accounts Receivable | Condition: The Municipality of Rio Grande has not completed the automatization of the process of levy and collection of the volume of business tax. The Municipality do not enforcement of tax collection. | Corrected |
| <u>NUMBER 03-06</u> Accounting for compensated absences | Condition Even though details of the days accrued by the employees is maintained manually by the Municipality, the dollar amounts of these accrued benefits are not maintained unless required for specific purpose. | Corrected |
| <u>NUMBER 03-07</u> "Liquidación presupuestaria" (Year End Budget Closing) | Condition The year end budget closing vs actual closing "Liquidación Presupuestaria" did not properly classified revenues, also it was noted expenses posted twice. | Corrected |
| <u>NUMBER 03-08</u> Section 8 Schedule of Utility | Condition The files were incomplete due to the lack of schedule of utility. | Partially Corrected |
| <u>NUMBER 03-09</u> Office Conditions | Condition Section 8 office have filtration problems | Still Prevail |
| <u>NUMBER 03-10</u> Information Packet Incomplete | Condition The letter for procedures against discrimination is not included in the Information Packet when given to the tenants. | Corrected |



Estado Libre Asociado de Puerto Rico
Municipio de Río Grande
Oficina del Alcalde

Hon. Emilio Rosa Pacheco
ALCALDE

CORRECTIVE ACTION PLAN

December 18, 2004

Cognizant or Oversight Agency for Audit:

The Municipality of Río Grande respectfully submits the following corrective action plan for the year ended June 30, 2004.

Name and address of independent public accounting firm: Juan Rivera, CPA, Mireya G-23, Ave. Boulevard, Levittown, Puerto Rico 00949.

The findings from the June 30, 2004 schedule of finding and questioned cost are discussed below and are numbered consistently with the numbers assigned in the schedule.

FINDING NUMBER 04-01

Personnel

Recommendation:

Do a purge of all personnel files, regardless of the year, in order to evidence employee's good standing.

Action Taken:

The Human Resource Office will be working in order to have the documents complete for the next audit period. We will be requesting to the municipality employees the documents necessary to evidence their good standing.

FINDING NUMBER 04-02

Disbursement Test

Recommendation:

Follow the procedures necessary to attach all the information required to have a good internal control and to comply with the regulation.

FINDING NUMBER 04-02
Disbursement Test (cont)

Action Taken:

In order to comply with a good internal control, the Municipality will enforce preinterventor to verify that documents attach to voucher are complete.

Finding Number 04-03
Accounting and Reporting System

In order to streamline the accounting and reporting systems and provide proper closing of records and adequate and timely information, we recommend the Municipality to consider the acquisition of new accounting systems.

The Municipality should implement a new accounting system that allows the preparation of monthly and year-end financial statements in accordance with accounting principles generally accepted in the United States of America applicable to government entities. This plan should provide for the following.

- a. Adequate training to all accounting personnel in order to improve the understanding of the system.
- b. The implementation of a double entry accounting system and the integration of all subsidiary ledgers.
- c. The preparation of periodic financial reports to be submitted to the Finance Director, the Mayor and the Municipality assembly.
- d. Reconciliation of financial with the reports prepared and submitted to the Federal government, and The preparation of the general purpose financial statement in accordance to Accounting principles generally accepted in the United States of America.

Finding Number 04-03
Accounting and Reporting System (cont)

Action Taken:

We made contact with OCAM'S Auxiliary Director of Information System, Mr. Javier Castro, in order to notify him all the findings related to the municipalities accounting system. Mr. Castro and his staff will be helping us to get up to date the municipality's Accounting System, according to the recommendation of external audits and federal agencies.

FINDING NUMBER 03-04
Bank Accounts and cash Management

Recommendation:

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

Action Taken:

The Finance Director was instructed to give the necessary follow up on this matter to make sure that all accounts will be reconciliated as established by law.

FINDING NUMBER 03-05
Volume of Business tax

Recommendation:

The Municipality must establish the necessary procedures to comply with the law, regulation, and internal control mentioned above. Also the Municipality must establish a system to recognize the volume of business tax certification with the taxpayer to make easily the way to find documents.

Action Taken:

The municipality will designate a person, either a collector or any other person designated to keep control of all the documents related to Volume of Business Tax.

FINDING NUMBER 04-06

Revenues

Recommendation:

The municipality must establish the necessary procedures to comply with the law referred above.

Action Taken:

The Finance Director and The Municipal Collector's Supervisor, Mrs. Margarita Melendez were instructed in this behave so situation like this could not happen again.

FINDING NUMBER 04-07

Contracts

Recommendation:

The Municipality's Secretary must review all the contracts to ensure the completeness of them and encourage the promptly settle of contracts.

Action Taken:

The Municipality's Internal Auditing Office will give the necessary follow up on this matter to make sure that the municipal contracts for next year will be complete with all the necessary clauses established by law.

FEDERAL AWARD FINDINGS DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FINDING NUMBER 04-08

Schedule of Utility

Recommendation:

All files for tenants should be revised annually to insure that changes in utilities were kept and if there are no changes, a new calculation sheet should be made in the calculation of rent for the period mentioned above. For people who have more than one file, a copy of the schedule should be kept in the most recent file.

FINDING NUMBER 04-08
Schedule of Utility(cont.)

Action Taken:

The Municipality's Section 8 Coordinator was instructed to enforce the recommendations on this matter and we hope this finding for next years audits will be resolve.

FINDING NUMBER 04-09
Office Conditions

Recommendation:

Contact municipal offices in charge of repairing the problem in order for the same to be carried out as soon as possible.

Action Taken:

Quotation prices were given to the Finance Department to be evaluated to begin as soon as possible with the repairs. This work should be done before the end of the fiscal year 2004-05.

The Municipality has made arrangements to contract a Handicap Ram to access the main entrance of the Section 8 Office.

FINDING NUMBER 04-10
Cash Management

Recommendation:

Comment this problem with HUD office about the amount in the Section 8 bank account and request a solution for this situation.

Action Taken:

The Section 8 Coordinator, Mrs. Ana D. Medero, was instructed to consult this problem with HUD Office and seek a solution for this situation.

FINDING NUMBER 04-11
High Quality Standards

Recommendation:

The Municipality should improve the HQS procedures in order to comply with federal regulations.

Action Taken:

We will proceed to evidence the re-inspections and the fixing of the Units in order to comply with the standards of safe place.

FINDING NUMBER 04-12
Tenants Files

Recommendation:

The Municipality should purge all participants file in order to have filed the form 50058.

Action Taken:

The Section 8 Coordinator, Mrs. Ana D. Medero was Instructed to purge all participants file to make sure that all files have the form 50058 completed.

FINDING NUMBER 04-13
Documents for Tenants Qualification

Recommendation:

The Municipality should update the file with the documents necessary for comply with internal control of tenants qualification.

Action Taken:

A revision will be made before the ending of fiscal year 2004-05 to make sure all tenant files are update with the necessary documentation.

FINDING NUMBER 04-14
Commingling of Funds

Recommendation:

The Municipality should verified transaction between federal funs to avoid this situation.

Action Taken:

We will be verifying the different transaction between federal funds to avoid violations to the Code of Federal Regulation. The Municipality's Auditing Office was instructed to give the necessary follow up to this situation.

FINDING NUMBER 04-15
CDBG Disbursement

Recommendation:

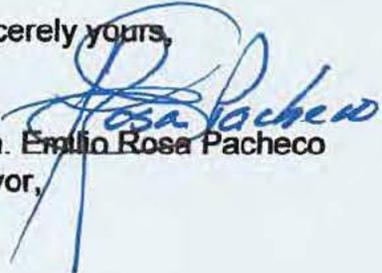
Maintain the documents required to support the disbursement in file and follow the procedures to have a good internal control.

Action Taken:

A revision will be made before the ending of fiscal year 2004-05 to make sure all disbursements have tenant the necessary documentation.

If the Cognizant or Oversight for Audit has questions regarding this plan, please call (787) 262-7704

Sincerely yours,


Hon. Emilio Rosa Pacheco
Mayor,