

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

MUNICIPIO DE SAN GERMAN
AUDITORIA 2003-2004
30 DE JUNIO DE 2004

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

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

FISCAL YEAR ENDED JUNE 30, 2004

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

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FINANCIAL SECTION

Independent Auditor's Report

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

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

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

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

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

In accordance with *Government Auditing Standards*, we have also issued a report dated January 20, 2005 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 4 through 12 and the Budgetary Comparison Schedule – General Fund on page 43 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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



Rodriguez, Rivera & Toro LLP

**Commonwealth of Puerto Rico
Municipality of San German
MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004**

Our discussion and analysis of the Municipality of San German's financial performance provides an overview of the municipality's financial activities for the year ended June 30, 2004,

Financial Highlights

- The assets of the Municipality exceeded its liabilities at the close of the fiscal year by \$26,753,784 (net assets), of which \$24,081,214 were invested in capital assets (net of accumulated depreciation, and related debt) and \$4,573,609 were restricted. The unrestricted fund balance has a negative balance of \$1,901,039.
- The Municipality's total net assets increased by \$3,113,686 from previous year restated balance.
- During the year, the Municipality generated revenues from taxes and other sources in the amount \$20,007,122 (excluding any gain and special items) while expenses amounted to \$20,407,598, resulting in an increase in net assets of \$ 3,113,686 after a gain in sale of property of \$1,056,620 and revenues from property tax amnesty of \$423,062 and from donated property of \$ 2,034,480.
- As of the close of the current year, the general fund in the Municipality's Governmental Funds Balance Sheet reported ending fund balance of \$2,194,627 of which \$486,747 is reserved for encumbrances and \$1,707,880 is available for spending at the government's discretion (unreserved fund balance)
- The Debt Service reported a fund balance of \$1,942,864.
- The Commonwealth Legislative Resolution Fund reported a fund balance of \$1,696,605.
- Other Governmental Funds reported a fund balance of \$2,324,067 of which \$1,450,568 is restricted for capital projects and \$ 873,499 for other specified purposes.
- The Municipality's long term debt increased by \$355,000.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Municipality's basic financial statements. The municipality's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. In addition to the basic financial statements, this report contains other supplementary information.

Government-wide financial statements are designed to provide readers with a broad overview of the Municipality's finances, in a manner similar to a private sector business.

The Statement of Net Assets presents information on all of the municipality's assets and liabilities, with the difference between the two reported as net assets. Over time, increases

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MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004

or decreases in net assets may serve as a useful indicator of whether the financial position of the municipality is improving or deteriorating.

The Statement of Activities presents information showing how the government's net assets changed during the most recent year. 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 result in cash flows in future fiscal periods.

Fund financial statements - 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 uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statement. However, unlike the government-wide financial statement, governmental fund financial statement focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government'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 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 government's near-term financing decisions. Both the governmental fund balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide reconciliation to the government-wide statements in order to facilitate this comparison between governmental funds and governmental activities.

The municipality has many individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the fund statement of revenues, expenditures, and changes in fund balance for the General Fund, and the Debt Service Fund, data from the other governmental funds are combined into a single, aggregated presentation termed Other Governmental Funds.

The Municipality adopts an annual appropriated budget for the general fund. A budgetary comparison statement has been provided to demonstrate compliance with this budget.

Notes to the financial statement provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements, and is required by accounting principles generally accepted.

Commonwealth of Puerto Rico
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MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the municipality, assets exceed liabilities by \$26,753,784 at the close of the current fiscal year.

A significant portion of the municipality's net assets (90%) reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related debt to acquire those assets that is still outstanding. The municipality uses these capital assets to provide services to citizens; consequently these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. This category represented 87% of net assets in the prior year. This increase is mostly due to spending in some large projects which include spending of \$1,080,920 on roads pavement, \$2,433,745 on going projects and the donation of property by the Department of Recreation of the Commonwealth of Puerto Rico valued at \$2,034,480.

An additional portion of the Municipality's net assets 17% represents resources that are subject to external restrictions on how they may be used.

Unrestricted net assets reported a deficit of \$1,901,039. This deficit in unrestricted governmental net assets arose primarily because of the inclusion of the unused employee's regular vacations, sick days and compensated absences which will be included in future year's budget as they come due.

Following is a summary of the Municipality's Net Assets as found on page 12 of this report.

	<u>Net Assets</u>			
	<u>Governmental Activities</u>			
	2004	2003 as restated	Change	%
Current and other assets	\$ 8,394,073	\$ 6,544,374	\$ 1,849,698	28%
Non-current assets	37,474,566	35,780,448	1,694,118	5%
Total Assets	\$ 45,868,639	\$ 42,324,822	\$ 3,543,817	8%
Current liabilities	\$ 5,719,995	\$ 4,406,228	\$ 1,313,767	30%
Non-current liabilities	13,394,860	14,278,496	(883,636)	6%
Total liabilities	19,114,855	18,684,724	430,131	2%
Net Assets				
Investment in Capital Assets	24,081,214	20,746,640	3,334,574	16%
Restricted	4,573,609	3,486,311	1,087,298	31%
Unrestricted	(1,901,039)	(592,853)	(1,308,186)	221%
Total net assets	\$26,753,784	\$23,640,098	\$ 3,113,686	13%

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MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004

Changes in Net Assets, Governmental Activities

Following is a summary of the Municipality's changes in net assets which can be found on page 13 of this report.

Municipality of San German					
Statement of Activities					
Changes in Net Assets					
Governmental Activities					
	2004	%of Total	2003 as restated	Change	% of Change
Revenues:					
Program revenues:					
Charges for services	\$ 3,692,100	19%	\$ 4,029,381	\$ (337,281)	-8%
Operating grants and contributions	1,602,431	8%	745,862	856,569	115%
Capital grants and contributions	4,340,098	20%	2,706,566	1,633,532	60%
General revenues:					
Property taxes	4,201,708	21%	3,837,971	363,737	9%
Municipal taxes	1,980,917	10%	2,025,041	(44,124)	-2%
Other grants and contributions	3,862,123	20%	4,132,691	(270,568)	-7%
Interest	73,920	0%	107,163	(33,243)	-31%
Other	253,826	1%	1,073,214	(819,388)	-76%
Total revenues	\$ 20,007,122	100%	18,657,889	1,349,233	7%
Expenses:					
General government	4,925,537	24%	4,738,125	187,412	3%
Public Safety	1,217,345	6%	1,203,658	13,687	1%
Public Works	9,615,445	48%	7,956,371	1,659,074	20%
Sanitation	1,438,916	7%	1,427,156	11,760	1%
Health	747,339	4%	683,514	63,825	9%
Welfare	1,315,930	6%	1,032,517	283,413	27%
Culture and recreation	351,145	2%	338,159	12,986	3%
Education	347,501	2%	312,295	35,206	11%
Interest on long-term debt	448,440	2%	489,353	(40,913)	-8%
Total expenses	20,407,598	100%	18,181,148	2,226,450	12%
Increase(decrease) in net assets	(400,476)		476,741	(877,217)	-184%
Others financing sources					
Gain on sale of property	1,056,620		31,714	1,024,906	3232%
Special items					
Property tax amnesty	423,062			423,062	100%
Transfer of land and recreational facilities	2,034,480			2,034,480	100%
Increase in net assets	3,113,686		508,455	2,605,231	512%
Net assets at beginning of year					
as restated	23,640,098		23,131,643	508,455	2%
Net assets end of year	\$ 26,753,784		\$ 23,640,098	\$ 3,113,686	13%

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MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004

Presented in the chart above are comparisons of the current and prior year revenues and expenses for various activities of the city. Key elements of the changes in these programs are as follows:

- Governmental activities increased the Municipality's net assets by \$3,113,686.
- The Municipality's total revenues (excluding special items) increased by 7% to \$20,007,122 millions. Forty percent (40%) of total revenues comes from central and federal government grants, approximately 30% comes from property and municipal taxes and only 19% of total revenues come from charges for services.
- The municipality's expenses cover a range of services with about 72% related to general government and public works.
- Expenses increased by 12% from previous year to a total of \$20,407,598. The gain on the sale of land for \$1,056,620, revenues received of \$423,062 from the property tax amnesty and the transfer of property by the Department of Recreation valued on \$2,034,480 off-settled the decrease of \$ 400,476 in net assets.
- The decrease in other revenues is mainly due to \$893,514 received from PREPA reported as revenue on prior fiscal period (2002-2003) financial statements.

Financial Analysis of the Governmental Funds

The Municipality of San German 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 spendable resources. Such information is useful in assessing the municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of June 30, 2004 the Municipality reported combined ending fund balance of \$8,158,163, a decrease of \$385,102 in comparison with the prior year. Approximately 21% of the ending fund balance which amounts to \$1,707,880 constitutes unreserved fund balance. The remainder is reserved to indicate that it is not available for new spending because it has already been committed; 1) as a reserve for encumbrances \$486,747; 2) to pay debt service \$1,942,864), reserved for specified purposes \$1,780,445, and 4) reserved for capital projects \$2,240,227.

General Fund

The general fund is the primary operating fund of the municipality. At the end of the current fiscal year, unreserved fund balance of the general fund was \$1,707,880, while the

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MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004

total fund balance was \$2,194,627. Of this total \$486,747 was reserved for encumbrances. As a measure of the general fund liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditure. Unreserved fund balance represents 12% of total general expenditures while total fund balance represents 16%.

The following schedule presents a summary of general fund revenues and expenditures for the fiscal year ended June 30, 2004 in relation to prior year totals.

	2004 General Fund	Percent of Total	2003 General Fund	Percent of Total	Increase (Decrease)	Percent of Increase (Decrease)
Revenues						
Property taxes	\$ 2,978,444	23%	\$ 3,087,978	24%	(109,534)	0%
Municipal tax, licenses and permits	1,980,917	15%	2,025,041	15%	(44,124)	-2%
Intergovernmental	5,601,658	43%	5,276,111	40%	325,547	26%
Rental income and charges for Services	1,931,145	15%	2,522,751	19%	(591,606)	-23%
Fines and forfeitures	2,880	0%	1,160	0%	1,720	148%
Interest	54,200	1%	80,940	1%	(26,740)	-33%
Other	<u>403,397</u>	<u>3%</u>	<u>131,740</u>	<u>1%</u>	<u>271,657</u>	1037%
Total Revenues	<u>\$12,952,641</u>	<u>100%</u>	<u>\$ 13,125,721</u>	<u>100%</u>	<u>(173,080)</u>	1.34%

- Both property and municipal taxes had a slight decrease over prior year.
- Charges for services was affected by a decrease in construction permits, and
- The decrease in interest revenues was due to the decline in interest rates.

	2004 General Fund	Percent of Total	2003 General Fund	Percent of Total	Increase (Decrease)	%
Expenditures						
General government	\$ 4,161,963	30%	\$ 4,259,655	33%	\$ (2,799)	-1%
Public safety	847,794	6%	824,937	6%	22,857	3%
Public works	5,239,244	38%	4,650,006	36%	589,238	13%
Sanitation	1,415,944	10%	1,404,184	11%	11,760	1%
Health	747,339	5%	683,514	5%	63,825	9%
Welfare	399,422	3%	375,129	3%	24,293	6%
Culture and recreation	342,157	2%	329,170	3%	12,987	4%
Capital outlays	476,771	3%	94,893	7%	381,878	402%
Education	<u>340,055</u>	<u>2%</u>	<u>309,115</u>	<u>2%</u>	<u>30,940</u>	10%
Total Expenditures	<u>\$13,970,689</u>	<u>100%</u>	<u>\$ 12,835,710</u>	<u>100%</u>	<u>\$ 1,134,979</u>	9%

Commonwealth of Puerto Rico
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MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004

- Expenditures exceeded revenues by \$1,018,048 this deficiency was off-settled by the proceed of the sale of capital asset by \$ 1,094,942, revenues from property tax amnesty of \$ 307,432 and the settlement of a legal case for \$ 893,514. After deducting the net of transfer in from other funds and transfer out to other funds for \$590,682, there is a net change in fund balance of \$ 687,158.
- General expenditures increased by 9% from prior year mostly because an increase in salaries and in marginal benefits

Other Governmental Funds

Financial highlights of the municipality's other funds are as follows:

- Debt Service fund balance increased by \$165,209
- At the end of the current fiscal year the other governmental fund balances shows a deficit of \$740,485, caused mostly by expenditures related to general obligation bonds which proceeds were recognized in previous years.

General Fund Budgetary Highlights

- During the year the Municipal Legislature approved an increase in the budget of \$1,588,137 of which \$624,850 comes from prior year fund balance, \$893,514 are proceeds from lawsuit settlement against the "Puerto Rico Electric Power Authority"(PREPA) and the rest are revenues transferred in from other funds. Other differences between initial and final budget is due to changes among departments.
- Actual revenues exceeded budget by \$555,236. The most significant positive variances were in property taxes and in other revenues. Other revenues include the sale of property in the amount of \$1,090,941.
- Rental income and service for charges and interest revenues were lower that expected, because actual municipal construction taxes were less than estimates and a decrease in interest rate
- Actual expenditures were lower by \$125,820 than final budget amounts
- The municipality's change in fund balance of \$687,158 differs from the General Fund Budgetary Fund of \$555,236 reported in the budgetary comparison schedule. This is primarily because the budgetary fund balance includes encumbrances of \$486,747 and the exclusions of other accruals made for GAAP purposes.

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Municipality of San German
MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004**

Capital Assets

Investment in capital assets for governmental activities as of June 30, 2004, amounted to \$32,489,620 millions (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, park facilities, roads, bridges and construction in progress.

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

	Capital Assets As of June 30,	
	Governmental Activities	
	2004	2003 (as restated)
Non-depreciable assets:		
Land and improvements	\$ 5,803,887	\$ 3,851,259
Construction in progress	4,294,520	2,048,850
Depreciable assets:		
Buildings and improvements	11,392,836	11,550,272
Equipment	3,075,421	3,537,368
Roads	5,917,318	5,486,543
Bridges	2,005,638	2,082,657
Total	\$ 32,489,620	\$ 28,556,949

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

Construction of bridge	\$ 2,241,517
Renovation to Old City Hall	260,294
Refurbishment of a theater (Teatro Parque)	139,636
Parks improvements	856,766

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

- \$2,034,479 of land and property donated by the Puerto Rico Department of Recreation and Sports.
- \$ 476,771 in equipment.
- \$1,080,920 in road pavement and replacement.

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

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Municipality of San German
MANAGEMENT DISCUSSION AND ANALYSIS
For the year ended June 30, 2004**

Debt Administration

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

	Outstanding Long-term Debt	
	Fiscal years ended June 30,	
	Governmental Activities	
	2004	2003 (as restated)
Bonds and notes payable	\$ 7,909,272	\$ 8,516,431
Compensated absences	2,955,717	2,501,681
Claims and judgments	23,240	128,307
Bond anticipation note	3,000,000	3,000,000
Payable to CRIM –delinquent accounts	390,563	470,818
Christmas Bonus Payable	332,584	332,912
LIMS debt	432,803	477,428
Total	\$ 15,044,179	\$ 15,427,577

At the end of the current fiscal year, the Municipality had a total bonded debt and notes payable outstanding of \$7,909,272. A new debt resulted from the issuance of a \$355,000 loan for the completion of the construction of a bridge. Other obligations include a \$3,000,000 bond anticipation loan, accrued Christmas bonus, compensated absences and vacation and sick days, and a debt to the Municipal Revenue Collection Center (CRIM). Compensated absences and vacations are paid when due.

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

Economic Factors and Next Year's Budget Rates

The approved budget for the fiscal year 2004-2005 amounted to \$13,962,585. That is an increase of \$849,862 over the current year budget. This increase is due to the expected increase in municipal taxes for fiscal year 2004-2005

In the preparation of fiscal year 2004-2005 budget, no increase in taxes was contemplated. Figures for property taxes and intergovernmental revenues are based on estimates prepared by the Municipal Revenue Collection Center (CRIM).

This report is designed to provide our citizens taxpayers, customers, and creditors with a general overview of the municipality's finances and to show the municipality's accountability for the money it receives. If you have any question about this report or need additional information, contact the Municipality's Director of Finance at P.O. Box 85, San German, Puerto Rico 00683.

**Commonwealth of Puerto Rico
Municipality of San German
Statement of Net Assets
June 30, 2004**

	<u>Governmental Activities</u>
<u>Assets</u>	
<u>Current Assets:</u>	
Cash and cash equivalents (note A5)	\$ 7,003,123
Receivables (net where applicable of allowance for uncollectibles) (note C)	
Commonwealth governmental agencies	509,308
Municipal license taxes	528,522
Federal Government	213,032
Others	<u>140,088</u>
Total Current Assets	<u>8,394,073</u>
<u>Non-Current Assets</u>	
Restricted assets:	
Cash and cash equivalents	797,514
Cash with fiscal agents	4,150,456
Deferred charges (note A5e)	36,976
Capital assets:(note F)	
Land and construction in progress	10,098,407
Other capital assets, net	<u>22,391,213</u>
Total capital assets	<u>32,489,620</u>
Total Noncurrent Assets	<u>37,474,566</u>
Total Assets	<u>\$ 45,868,639</u>
<u>Liabilities</u>	
<u>Current Liabilities</u>	
Accounts payable and accrued liabilities	\$ 541,415
Interest payable	200,284
Due to Commonwealth agencies (note G)	138,864
Due to federal government (note G)	51,591
Deposits payable	67,153
Deferred revenues (note H)	3,071,369
Current portion of long-term obligations (note I)	<u>1,649,319</u>
Total Current Liabilities	<u>5,719,995</u>
<u>Noncurrent Liabilities:</u>	
Non current portion of long-term obligations (note I)	<u>13,394,860</u>
Total Liabilities	<u>19,114,855</u>
<u>Net Assets</u>	
Invested in capital assets, net of related debt	24,081,214
Restricted for:	
Capital projects	245,363
Debt service	2,646,576
Other specified purposes	1,681,670
Unrestricted (deficit)	<u>(1,901,039)</u>
Total Net Assets	<u>\$ 26,753,784</u>

The accompanying notes are an integral part of these financial statements.

**Commonwealth of Puerto Rico
Municipality of San German
Statement of Activities
For the year ended June 30, 2004**

Functions	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Fees, Fines and Charges for Services	Operating Grants and Contributions		Capital Grants and Contributions
Governmental activities:					
General government	\$ 4,925,537	\$ 2,164,573	\$ 294,697	\$ -	\$ (2,466,267)
Public safety	1,217,345	-	177,798	-	(1,039,547)
Public works	9,615,445	1,527,527	-	4,340,098	(3,747,820)
Sanitation	1,438,916	-	-	-	(1,438,916)
Health	747,339	-	-	-	(747,339)
Welfare	1,315,930	-	877,918	-	(438,012)
Culture and recreation	351,145	-	193,911	-	(157,234)
Education	347,501	-	58,107	-	(289,394)
Interest on long-term debt	448,440	-	-	-	(448,440)
Total government activities	\$ 20,407,598	\$ 3,692,100	\$ 1,602,431	\$ 4,340,098	(10,772,969)
General Revenues:					
					4,201,708
					1,980,917
					3,862,123
					73,920
					253,825
					1,056,620
Special Items (note S)					
					423,062
					2,034,480
					<u>13,886,655</u>
					3,113,686
					23,640,098
					<u>\$ 26,753,784</u>

The accompanying notes are an integral part of these financial statements.

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

	Major Funds				Total Governmental Funds
	General	Debt Service	Commonwealth Legislative Resolutions	Other Governmental Funds	
Assets					
Cash and cash equivalents (note A5)	\$ 4,157,801	\$ -	\$ 1,713,327	\$ 1,131,996	\$ 7,003,124
Receivables (net where applicable of allowance for uncollectibles)					
Commonwealth governmental agencies	21,867	49,134	-	283,832	354,833
Municipal license taxes	528,522	-	-	-	528,522
Federal government		-	-	213,032	213,032
Others	140,089	-	-	-	140,089
Due from other funds (note D)	899,926	-	-	-	899,926
Restricted Assets					
Cash and cash equivalent	-	-	-	797,514	797,514
Cash with fiscal agents (note E)	-	2,795,582	-	1,354,874	4,150,456
Total assets	\$ 5,748,205	\$ 2,844,716	\$ 1,713,327	\$ 3,781,248	\$ 14,087,496
Liabilities					
Accounts payable and accrued liabilities	\$ 153,816	\$ -	\$ 828	\$ 386,771	\$ 541,415
Matured bonds and notes payable	-	732,500	-	-	732,500
Matured interest payable	-	169,352	-	-	169,352
Due to Commonwealth governmental agencies (note G)	138,864	-	-	51,591	190,455
Due to other funds (note D)		-	15,894	884,032	899,926
Deposits payable	67,153	-	-	-	67,153
Deferred revenues (note H)	3,193,745	-	-	134,787	3,328,532
Total liabilities	3,553,578	901,852	16,722	1,457,181	5,929,333
Fund Balance					
Reserve for encumbrances	486,747	-	-	-	486,747
Reserve for debt service	-	1,942,864	-	-	1,942,864
Reserve for capital projects	-	-	789,659	1,450,568	2,240,227
Reserved for other specified purposes	-	-	906,946	873,499	1,780,445
Unreserved	1,707,880	-	-	-	1,707,880
Total fund balances	2,194,627	1,942,864	1,696,605	2,324,067	8,158,163
Total liabilities and fund balance	\$ 5,748,205	\$ 2,844,716	\$ 1,713,327	\$ 3,781,248	\$ 14,087,496

The accompanying notes are an integral part of these financial statements.

**Commonwealth of Puerto Rico
Municipality of San German
Reconciliation of the Balance Sheet of Governmental Funds
to the Statement of Net Assets
June 30, 2004**

Fund Balance - total governmental funds		\$ 8,158,163
Amounts reported for the governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds:		32,489,620
Assets are not available to pay for current period expenditures and therefore are not considered in the funds:		
Deferred charges-bond issuance costs	36,976	
Christmas Bonus	154,475	191,451
Other assets are not available to pay for current period expenditures and therefore are deferred in the funds:		
Receivables:		
CRIM (current year)	57,187	
Rent and construction permits	65,188	
Intergovernmental grants	134,788	257,163
Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds:		(30,934)
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds:		
General obligation bonds and notes	7,176,772	
Bond anticipation note	3,000,000	
Compensated Absences	2,955,717	
Claims and judgments	23,240	
CRIM - delinquent accounts	390,563	
CRIM - LIMS	432,803	
Christmas bonus	332,584	(14,311,679)
Net assets of governmental activities		\$ <u>26,753,784</u>

The accompanying notes are an integral part of these financial statements.

Commonwealth of Puerto Rico
Municipality of San German
Statement of Revenues, Expenditures, and Changes in Fund Balance -
Governmental Funds
For the year ended June 30, 2004

	Major Funds				Total Governmental Funds
	General Fund	Debt Service	Commonwealth Legislative Resolutions	Other Governmental Funds	
Revenues					
Property taxes (note J)	\$ 2,978,444	\$ 1,281,177	\$ -	\$ -	\$ 4,259,621
Municipal license taxes (note K)	1,980,917	-	-	-	1,980,917
Intergovernmental (note L)	5,601,658	-	1,273,731	1,574,779	8,450,168
Federal Grants	-	-	-	2,959,231	2,959,231
Rental income and charges for services	1,931,145	-	-	-	1,931,145
Fines and forfeitures	2,880	-	-	-	2,880
Interest	54,200	19,476	-	244	73,920
Other	403,397	-	-	72,454	475,851
Total Revenues	12,952,641	1,300,653	1,273,731	4,606,708	20,133,733
Expenditures					
Current					
General government	4,161,963	-	168	395,614	4,557,745
Public safety	847,794	-	-	67,125	914,919
Public works	5,239,244	-	698,246	2,190,107	8,127,597
Sanitation	1,415,944	-	-	-	1,415,944
Health	747,339	-	-	-	747,339
Welfare	399,422	-	114,499	765,329	1,279,250
Culture and recreation	342,157	-	-	-	342,157
Education	340,055	-	-	7,446	347,501
Capital outlays	476,771	-	5,054	3,511,615	3,993,440
Debt service					
Principal	-	902,159	-	-	902,159
Interest	-	394,554	-	-	394,554
Total expenditures	13,970,689	1,296,713	817,967	6,937,236	23,022,605
Excess (deficiency) of revenue over expenditures	(1,018,048)	3,940	455,764	(2,330,528)	(2,888,872)
Other financing sources (uses)					
Proceeds from sale of capital assets	1,094,942	-	-	-	1,094,942
Proceeds from general obligation bonds	-	-	-	355,000	355,000
Transfers in	20,486	66,125	-	1,235,043	1,321,654
Transfers out	(611,168)	(20,486)	(690,000)	-	(1,321,654)
Total Other Financing sources (uses)	504,260	45,639	(690,000)	1,590,043	1,449,942
Special items (note S)					
Property taxes-amnesty	307,432	115,630	-	-	423,062
Legal case settlement- PREPA	893,514	-	-	-	893,514
Total special items	1,200,946	115,630	-	-	1,316,576
Net change in fund balance	687,158	165,209	(234,236)	(740,485)	(122,354)
Fund balance at beginning of year, as restated (note Q)	1,507,469	1,777,655	1,930,841	3,064,552	8,280,517
Fund balance at end of year	\$ 2,194,627	\$ 1,942,864	\$ 1,696,605	\$ 2,324,067	\$ 8,158,163

The accompanying notes are an integral part of these financial statements.

Commonwealth of Puerto Rico
Municipality of San German
Reconciliation of the Statement of Revenues, Expenditures, and
Changes in Fund Balances of Governmental Funds to the Statement of Activities
For the year ended June 30, 2004

Net change in fund balances - total governmental funds		\$ (122,354)
<p>Amounts reported for governmental activities in the Statement of Activities are different because:</p>		
<p>Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays (\$3,993,440) exceeded depreciation (\$2,060,893) in the current year:</p>	1,932,543	
<p>In the Statement of Activities, only the gain on the sale of property is reported, whereas in the governmental funds the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balance by the cost of land sold:</p>		(38,322)
<p>Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds:</p>		
CRIM (current year)	57,187	
Rent and construction permits	65,188	
Intergovernmental grants	134,788	
Christmas bonus	154,475	
Donated capital assets	2,038,455	2,450,093
<p>Revenues reported in funds which are not reported as revenues in the Statement of Activities:</p>		
Other revenues	56,665	
Puerto Rico Electric Power Authority (prior year)	1,109,345	
CRIM (prior year)	115,102	
Christmas bonus	154,627	(1,435,739)
<p>Expenditures reported in funds which are not reported as expenses in the Statement of Activities:</p>		
Matured bonds principal payments (net change)		(60,000)
<p>The issuance of a bond note provide current financial resources to governmental funds; however, issuing debt increases long term liabilities in the Statement of Net Assets:</p>		(355,000)
<p>Repayment of long-term debt consumes the current financial resources of governmental funds, but has no effect on net assets of governmental activities:</p>		
General obligation bonds and notes	962,159	
Other long term liabilities	770,384	1,732,543
<p>Governmental funds report the effect of bond issuance cost as expenditures when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This amount is the net effect of these differences:</p>		
Bond issuance cost	2,155	
Amortization of bond issuance costs	(5,933)	(3,778)
<p>Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:</p>		
Claims and judgments	(23,240)	
Accrued interest (net charges)	4,671	
Compensated absences	(635,147)	
Christmas bonus	(332,584)	(986,300)
Change in net assets of governmental activities		\$ 3,113,686

The accompanying notes are an integral part of these financial statements.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of San German was founded in the year 1573. The Municipality is comprised by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of fourteen members of the Municipality Legislature. The Municipality provides benefits to the community such as: health, public works, environmental control, human resources, education, public security, housing and community development, culture and recreation, and other general and administrative services.

The Municipality's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The more significant accounting policies established in GAAP and used by the Municipality are discussed below.

1. FINANCIAL REPORTING ENTITY

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

The basic criteria for deciding financial accountability are any one of the following:

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

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

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

In fiscal year 2003-04 the Municipality adopted Statement No. 39 "*Determining Whether Certain Organizations are Component Units— an amendment of GASB 34 Statement No. 14*". This statement amends GASB Statement No. 14 to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. A legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if all of the following criteria are met:

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

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

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

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

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

2. BASIC FINANCIAL STATEMENTS - GOVERNMENT-WIDE STATEMENTS

The Municipality's basic financial statements include both government-wide (reporting the Municipality as a whole) and fund financial statements (reporting the Municipality's major funds). Both the government-wide and fund financial statements categorize primary activities as governmental. The Municipality's police, parks, library and recreation, public works, sports arena, and general administrative services are classified as governmental activities.

In the government-wide Statement of Net Assets, the governmental activities are presented on a consolidated basis and are reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The Municipality's net assets are reported in three parts—invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The Municipality first utilizes restricted resources to finance qualifying activities.

The government-wide Statement of Activities reports both the gross and net cost of each of the Municipality's functions (police, public works, etc.). The functions are also supported by general government revenues (property and municipal taxes, certain intergovernmental revenues, fines, permits and charges, etc.). The Statement of Activities reduces gross expenses (including depreciation) by related program revenues which includes fees, fines, and charges for services, as well as operating and capital grants. Program revenues must be directly associated with the function (police, public works, community and youth services, etc.). Operating grants include operating-specific and discretionary (either operating or capital) grants while the capital grants column reflects capital-specific grants. Indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The net costs by function are normally covered by general revenue (property taxes, intergovernmental revenues, interest income, etc).

This government-wide focus is more on the sustainability of the Municipality as an entity and the change in the Municipality's net assets resulting from the current year's activities. Fiduciary Funds are not included in government wide financial statements. The effect of interfund activities is eliminated. Private sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government wide statements to the extent that those standards do not conflicts with or contradicts guidance of the Governmental Accounting Standard Board. The municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 1, 1989.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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

Invested in capital assets, net of depreciation:

Consist of capital assets balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital assets acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.

Restricted net assets:

Represent net assets that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and requirements of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

Unrestricted net assets:

Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

3. BASIC FINANCIAL STATEMENTS - FUND FINANCIAL STATEMENTS

The financial transactions of the Municipality are reported in individual funds in the fund financial statements. Each fund is accounted for by providing a separate set of self-balancing accounts that comprises its assets liabilities reserves fund equity, revenues and expenditures/expenses. An emphasis placed on major funds category. A fund is considered major if it is the primarily operating fund of the Municipality or meets the following criteria:

- a. Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding total for all fund of that category or type; and
- b. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental fund or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.

The various funds are reported by generic classification within the financial statements.

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

The following fund types are used by the Municipality:

a. Governmental Funds

Governmental Funds are those through which most governmental functions of the Municipality are financed. The acquisition, uses, and balances of the Municipality expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position rather than upon net income determination. The Municipality reports the following major governmental funds:

General Fund - The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those required to be accounted for another fund.

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

Commonwealth Legislature Resolutions Fund - The Commonwealth Legislative Resolutions Fund is used to account for grants from the Commonwealth's Legislature.

b. Reservations of Fund Balance

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

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

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

4. BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues or expenditures/expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made, regardless of the measurement focus applied.

a. Accrual:

Governmental activities in the government-wide financial statements are presented on the accrual basis of accounting. Generally, revenues are recognized when earned and expenses are recognized when incurred. In applying GASB Statement No. 33 to revenues, property taxes are recognized as revenues the year taxes are levied and municipal license taxes when the underlying exchange has occurred. With respect to grants revenues the Municipality recognizes receivables and revenues when the applicable eligibility requirements, including time requirements, are met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Resources transmitted before the eligibility requirements are met are reported as deferred revenues.

b. Modified Accrual - Governmental Funds

These funds use the modified accrual basis of accounting. Under this basis of accounting revenues are recognized when susceptible to accrual; that is, when they are measurable and available. "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. The Municipality used for the recognition of all Governmental Fund revenues an availability period of 60 days after the year end. Substantially all governmental fund revenues are accrued. Property taxes, municipal license taxes, and grants revenues are recorded in accordance with the requirements of GASB No. 33 and are subject to the availability criteria described above. Intergovernmental grants revenues are considered earned and are accrued simultaneously with the grant expenditures unless such recognition is prohibited by the grant requirements, amounts represent unrestricted receipts or amounts are revocable only for failure to comply with prescribed compliance requirements. In such cases revenues are usually recognized at the time of receipt. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available. Expenditures are generally recognized when the related liability is incurred.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Exceptions to this rule are: accumulated unpaid vacations, sick pay, and other employee amounts which are not accrued and principal and interest on long-term debt in the debt service fund, which are recorded as expenditures when due, except for principal and interest due in July 1 of the following fiscal year which is recorded when resources are available in the debt service funds.

The Municipality reports deferred revenues on its combined balance sheet. Deferred revenues arises when potential revenue does not meet both measurable, available and collectibility criteria for recognition in the current period. Deferred revenues also arise when resources are received before the Municipality has a legal claim to them. (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

5. FINANCIAL STATEMENT AMOUNTS

a. Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, demand deposits and short term investments with original maturities of three months or less. The Municipality follows the practice of pooling cash of all funds except for certain state grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. The method of allocating interest earned on pooled investments among governmental fund types provides that, unless otherwise restricted, all interest is credited to the General Fund.

b. Receivables

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivables from Federal Government represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

d. Risk Financing

The Puerto Rico Department of Treasury acts as an agent, obtaining and determining the coverage for the cities and municipalities of Puerto Rico. The coverage for the Municipality of San German consists of professional, public responsibility, property and theft, auto and fidelity bond coverage. Payments of the Municipality's insurance premiums are withheld quarterly from property tax advances and subsidies sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Settled cases have not exceeded insurance coverage for any of the past three years.

e. Long term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities. Bond issuance costs are reported as deferred charges and amortized as required by current standards.

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

f. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. The vacation and sick leave for employees are accumulated on the basis of 2 1/2 days per month of vacations and 1 1/2 days per month of sick pay up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick pay is liquidated to employees with 10 years or more service up to the maximum number of days.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

f. Compensated absences - continued

The amount of vacation leave is accrued if earned based on services already performed by employees and if it is probable that will be paid in a future period. Amount of sick leave is accrued based on all vesting amounts for which payment is probable and on accumulated benefits as of the balance sheet date.

The accrual of compensated absences includes estimated payments that are related to payroll. The accrued expenditures for accumulated vacations and sick pay have been recorded as long-term liabilities in the government-wide statements. For governmental fund statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available resources.

g. Capital Assets

Capital assets purchased or acquired are reported at historical cost or estimated historical cost. Contributed assets are reported at fair market value as of the date received. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

Buildings	40 years
Machinery and Equipment	5-10 years
Improvements	10-20 years
Other Infrastructure	2-50 years

h. Use of Estimates

The preparation of the financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE A -NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

i. Interfund Receivables and Payables

During the course of operations, numerous transactions occur between individual funds that may result in amounts owed between funds. Those related to goods and services type transactions are classified as "due to and from other funds." Short-term interfund loans are reported as "interfund receivables and payables." Long-term interfund loans (noncurrent portion) are reported as "advances from and to other funds." Interfund receivables and payables between funds within governmental activities are eliminated in the Statement of Net Assets. Transfers are used to (a) move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them and to (b) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

j. Future Adoption of Accounting Pronouncements

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

- GASB Statement No. 40 "Deposit and Investment Risk Disclosure - an amendment to GASB Statement No.3" - to be implemented in fiscal year ended June 30, 2005.
- GASB Statement No. 42 "Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries"- to be implemented in June 30, 2006.
- GASB Statement No. 43 "Financial Reporting for Post employment Benefit Plans Other Than Pension Plans"- to be implemented in June 30, 2007.
- GASB Statement No. 44 "Economic Condition Reporting: The Statistical Section"- to be implemented in June 30, 2006
- GASB Statement No. 45 "Accounting and Financial Reporting by Employers for Post employment Benefits Other than Pensions" – to be implemented on June 30, 2010
- GASB Statement No. 46 "Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34"- to be implemented on June 30, 2007

NOTE B - DEPOSITS

Deposits in commercial banks of \$7,234,529 (bank balance) were secured at the balance sheet date by FDIC coverage and by pledged Puerto Rico and U.S. Governmental Securities held by P.R. Treasury Department as required by Commonwealth statutes. Book balance of these deposits amounts to \$7,003,124 which is reported as cash and cash equivalents in the financial statements. Deposits at the Governmental Development Bank of P.R. amounting to \$4,857,547 (bank balance) are unsecured and uncollateralized as no collateral is required to be carried by governmental banks. In addition, \$797,514 pertaining to the Rural Development Fund is held by federal agency. Book balance on these balances of \$4,150,456 and \$797,514 respectively are reported as restricted cash with fiscal agent and restricted cash and cash equivalents in the financial statements.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE C - RECEIVABLES

The Municipality's receivables as of June 30, 2004 are the following:

Description	State Governmental Agencies	Others
Municipal Revenues Collection Center (CRIM)	\$ 71,001	\$ -
Puerto Rico Treasury Department	154,475	-
Puerto Rico Department of Labor	283,832	
Construction permits	-	155,293
Rent	-	70,598
Others	-	112,113
Less: allowance for uncollectible accounts	-	(197,916)
Totals	\$ 509,308	\$ 140,088
Municipal license taxes, net of 179,009 of allowance for uncollectible accounts		<u>\$ 528,522</u>
Federal government (HUD)		<u>\$ 213,032</u>

NOTE D - INTERFUND TRANSACTIONS

The amount presented as due from (to) other funds in the governmental fund statements represents interfund transfers and /or borrowings between funds:

Operating transfers in (out):

Transfers between individual funds were made for operational purposes. Transfers includes interest earned on cash with fiscal agents in the debt service fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; reimbursements for expenditures from other governmental funds to the general fund and principal and interest payments of long term debt transferred from the general fund to the debt service fund.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE D - INTERFUND TRANSACTIONS-continued

Due from/to other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental funds-Law No. 82	\$ 20,419
	Other governmental funds-Law No. 52	286,151
	Other governmental funds-DEO	207,852
	Other government- CME	109,429
	Other governmental funds-OMEF	66,598
	Other governmental funds-CDBG	122,965
	Other governmental funds-Others	86,512
		<u>\$ 899,926</u>

NOTE E – RESTRICTED CASH AND CASH EQUIVALENTS AND CASH WITH FISCAL AGENT

Restricted cash and cash equivalents represents the undisbursed balance of bond anticipation notes held in custody of Rural Development. Cash with fiscal agents represents unspent proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Governmental Development Bank of Puerto Rico or a federal governmental instrumentality. Cash balance recognized in the debt service fund represents the unspent balance of property tax collections, which are restricted for the repayment of the Municipality's general, and special obligation bonds and notes. The sinking fund is maintained by the Governmental Bank of Puerto Rico, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with the law.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE F - CAPITAL ASSETS

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

	Beginning Balance, July 1, 2003 as restated	Increases	Decreases	Ending Balance June 30, 2004
Governmental activities:				
Capital assets not being depreciated:				
Land and improvements	\$ 3,851,259	\$ 1,967,749	\$ 15,121	\$ 5,803,887
Construction in progress	2,048,850	2,433,745	188,075	4,294,520
Total capital assets not being depreciated	<u>5,900,109</u>	<u>4,401,494</u>	<u>203,196</u>	<u>10,098,407</u>
Other capital assets:				
Buildings and improvements	15,908,168	254,806		16,162,974
Equipment	8,328,801	480,746	70,980	8,738,567
Roads	10,389,568	1,080,920	-	11,470,488
Bridges	3,151,798	1,995	-	3,153,793
Total other capital assets	<u>37,778,335</u>	<u>1,818,467</u>	<u>70,980</u>	<u>39,525,822</u>
Less accumulated depreciation for:				
Buildings and improvements	4,357,896	412,242	-	4,770,138
Equipment	4,791,433	919,492	47,779	5,663,146
Roads	4,903,025	650,145	-	5,553,170
Bridges	1,069,141	79,014	-	1,148,155
Total accumulated depreciation	<u>15,121,495</u>	<u>2,060,893</u>	<u>47,779</u>	<u>17,134,609</u>
Other capital assets, net	<u>22,656,840</u>	<u>(242,426)</u>	<u>23,201</u>	<u>22,391,213</u>
Governmental activities capital assets, net	<u>\$ 28,556,949</u>	<u>\$ 4,159,068</u>	<u>\$ 226,397</u>	<u>\$ 32,489,620</u>

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE F - CAPITAL ASSETS - Continued

Depreciation expense was charged to functions as follows:

	<u>Amount</u>
General government	\$ 207,917
Public safety	302,426
Public works	1,481,910
Culture and recreation	8,988
Sanitation	22,972
Welfare	<u>36,680</u>
 Total depreciation expense, governmental activities	 <u>\$ 2,060,893</u>

NOTE G - DUE TO GOVERNMENTAL AGENCIES

Due to governmental agencies as of June 30, 2004 follows:

• **Due to Commonwealth governmental agencies**

	<u>Amount</u>
Puerto Rico Department of Labor - (unemployment)	\$ 20,319
PRIDCO	30,945
Puerto Rico Retirement System	80,686
Other	<u>6,914</u>
	<u>\$ 138,864</u>

• **Federal Government**

Consist in amount due to HUD by Section 8 \$ 51,591

NOTE H - DEFERRED REVENUES

The amounts presented as deferred revenues in the general fund include the following:

<u>Description</u>	<u>Amount</u>
Municipal license taxes	\$ 3,060,722
Others	<u>10,647</u>
	<u>\$ 3,071,369</u>

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE I - LONG TERM LIABILITIES

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

Original Amount	Description	Maturity	Interest Rate	Installments	Outstanding Balance
\$ 400,000	Public Improvement Bond	January 1, 2007	5.00%	\$23,000 to \$27,204	\$ 78,204
1,150,000	Special Obligation Bond	July 1, 2006	8.5%	\$57,500	172,500
765,000	Public Improvement Bond	January 1, 2011	6.38%	\$39,000 to \$60,000	347,341
400,000	Public Improvement Bond	January 1, 2013	6.13%	\$17,000 to \$32,000	219,000
860,000	Public Improvement Bond	July 1, 2004	3.3 - 6.3%	\$105,000	105,000
616,000	Public Improvement Bond	January 1, 2012	5.00%	\$30,000 to \$45,227	302,227
3,500,000	Public Improvement Bond	July 1, 2015	4.7 - 6.6%	\$140,000 to \$330,000	2,695,000
390,000	General Obligation Bond	January 1, 2005	4.75%	\$61,000 to \$65,000	65,000
2,100,000	General Obligation Bond	July 1, 2013	2.7 - 4.6%	\$120,000 to \$235,000	1,710,000
1,435,000	General Obligation Bond	July 1, 2006	2.7 - 3.2%	\$285,000 to \$335,000	930,000
830,000	General Obligation Bond	July 1, 2026	2.7 - 5.6%	\$15,000 to \$75,000	810,000
130,000	General Obligation Bond	July 1, 2026	2.7 - 5.6%	\$5,000 to \$10,000	120,000
355,000	General Obligation Bond	July 1, 2028	2.36-6.00%	\$5,000 to \$30,000	355,000
					<u>\$7,909,272</u>

The annual requirements to amortize general obligation bonds and operational loans outstanding as of June 30, 2004 are as follows:

Maturing at June 30,	Principal	Interest	Total
2005	\$ 914,500	\$ 367,852	\$ 1,282,352
2006	795,500	338,527	1,134,027
2007	851,704	300,400	1,152,104
2008	468,000	276,072	744,072
2009	504,000	249,857	753,857
2010 - 2014	2,785,568	791,177	3,576,745
2015 - 2019	895,000	247,591	1,142,591
2020 - 2024	355,000	140,776	495,776
2025 - 2029	340,000	29,340	369,340
TOTALS	<u>\$ 7,909,272</u>	<u>\$ 2,741,592</u>	<u>\$ 10,650,864</u>

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE I – LONG TERM LIABILITIES - continued

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

	Beginning Balance, July 1, 2003 As Restated	Additions	Reductions	Ending Balance June 30, 2004	Amounts Due within One Year
Governmental activities:					
Bonds and notes payable:					
General obligation bonds	\$ 2,765,000	\$ 355,000	\$ 125,000	\$ 2,995,000	\$ 145,000
General obligation notes	1,441,000	-	446,000	995,000	350,000
Public improvement bonds	4,080,431	-	333,659	3,746,772	362,000
Special obligation bond	230,000	-	57,500	172,500	57,500
	<u>8,516,431</u>	<u>355,000</u>	<u>962,159</u>	<u>7,909,272</u>	<u>914,500</u>
Total bonds and notes payable					
Other liabilities:					
Compensated absences	2,501,681	635,147	181,111	2,955,717	169,063
Bond anticipation note	3,000,000	-	-	3,000,000	-
Note payable to CRIM – financing of delinquent account	470,818	-	80,255	390,563	162,612
Claims and judgment	128,307	23,240	128,307	23,240	23,240
Note payable to CRIM - LIMS	477,428	-	44,625	432,803	47,230
Christmas Bonus	332,912	332,584	332,912	332,584	332,584
	<u>6,911,146</u>	<u>990,971</u>	<u>767,210</u>	<u>7,134,907</u>	<u>734,819</u>
Total other liabilities					
	<u>\$ 15,427,577</u>	<u>\$ 1,345,971</u>	<u>\$ 1,729,369</u>	<u>\$ 15,044,179</u>	<u>\$ 1,649,319</u>

A \$3,000,000 bond anticipation note was issued by Rural Development for the construction of an infrastructure project. The municipality intends to refinance this note on a long term basis through a \$3,000,000 general obligation bond issuance, approved by the Governmental Development Bank of Puerto Rico on September 7, 2001. Issuance will occur after the construction project is finished. Rural Development disburses funds after the Municipality requests the payment of construction project certifications.

Debts to CRIM, compensated absences and claims and judgments will be financed with unrestricted funds.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE I – LONG TERM LIABILITIES - continued

Note payable to CRIM (LIMS)

On July 3, 2001 the municipality entered into a financing agreement with the CRIM in the amount of \$539,645 for the payment of the municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of tax payer's properties located in Puerto Rico. The note is payable in semiannual installments of \$36,188, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).

	Amount
	\$ 432,803

Debt service requirements in future years are as follows:

Maturing at June 30,	Principal	Interest
2005	\$ 47,320	\$ 24,824
2006	50,177	21,952
2007	53,207	18,907
2008	56,420	15,678
2009	59,827	12,254
2010-2012	165,852	14,269
Total	\$ 432,803	\$ 107,885

Note payable to CRIM (FINANCING OF DELINQUENT ACCOUNTS)

On March 26, 2002 the municipality entered into a financing agreement with the CRIM in the amount of \$ 470,818 to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a non revolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next 25 years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payment for the first 5 years will be financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first 5 years any collection from those delinquent accounts will be credited to the loan principal. After the 5 year period the loan outstanding balance will be restructured for a 25 years period. Debt service requirements in future years are as follows:

\$ 390,563

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE I – LONG TERM LIABILITIES - continued

Debt service requirements in future years are as follows:			<u>Amount</u>
June 30,	Principal	Interest	
2205	\$ 162,611	\$ 25,387	
2006	-	13,623	
2007	-	14,817	
2008	-	14,816	
2009	3,920	14,701	
2010-2014	23,904	69,200	
2015-2019	33,056	60,049	
2020-2024	45,712	47,394	
2025-2029	63,210	29,895	
2030-2032	58,150	7,024	
Total	<u>\$ 390,563</u>	<u>\$ 296,906</u>	

Compensated absences- includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds. \$ 2,955,717

Christmas bonus – represent the accrual portion corresponding to fiscal year 2003-2004 of the Christmas bonus to be paid on December 2004. \$ 332,584

Claims and judgement – represents the final settlement of two legal cases paid subsequent to June 30, 2004. The awarded amount of \$ 23,240 was paid with unrestricted funds. \$ 23,240

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE J – PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) (a state governmental agency) is responsible for the assessment, collection and distribution of real and personal property taxes in accordance with the Commonwealth Property Tax Law. The tax levied on property is determined by the Commonwealth and the Municipal Government based on limits established by the Commonwealth Legislature. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed, with the CRIM by May 15 of each year. Real property is assessed by the CRIM.

The tax is general assessed on January 1st on all taxable property located within the Municipality. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid in two equal installments, July 1st and January 1st. Property taxes are recorded as revenue by the Municipality in the year of receipt.

The tax rates in force as of June 30, 2004 are 8.53% for real property (of which 8.33% is paid by the taxpayer and 20% is reimbursed by the Puerto Rico Treasury Department) and 6.53% for personal property (of which 6.33% is paid by taxpayer and 20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.5% and 5.5% respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.5% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund

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

The CRIM advance funds to the Municipality based on an estimate of the property taxes to be levied and which are collected in subsequent periods. The CRIM collects such taxes and delivers to the Municipality's government any excess of taxes collected over the tax advances and amounts assigned for the repayment of the bond obligations. As part of the requirements of the Autonomous Municipal Law (Law number 80 of August 30, 1991), the CRIM determined a final settlement of funds distributed to municipalities. This distribution includes advances of property tax and amounts of municipal equalization fund from the state government. For the fiscal year 2003-2004 the CRIM performed the final settlement and determined that the Municipality has a net receivable of \$21,867. This amount was recorded as deferred revenue since is not available as required by current standards.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE K – MUNICIPAL LICENSE TAXES, LICENSES AND PERMITS

Municipal license taxes are assessed annually by the Municipality to all organizations or entity's subject to the tax doing business in the Municipality's location based generally on volume of business or gross sales. The Municipal license tax return should be submitted on April 15. If the tax is paid within the filing date a discount is allowed. If it is not paid on the filing date it can be paid in two equal installments (July 1st and January 1st following April 15 filing due date), but the discount is not allowed. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$3,060,722 are recorded as deferred revenues.

NOTE L – INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of Christmas bonus reimbursement of \$264,524; revenues for municipal equalization fund of \$3,593,775 received from the Commonwealth of Puerto Rico and \$1,743,359 received from the Puerto Rico Electric Power Authority for compensation in lieu of tax. Amount recorded in other governmental funds consists of state governmental grants.

NOTE M – RETIREMENT PLAN

a. Plan Description

Regular employees of the Municipality contribute to a cost sharing multiple-employer defined benefit retirement plan, administered by the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members for occupational and non occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE M – RETIREMENT PLAN - continued

Law No. 305 of September 24, 1999 amended the Act No. 447 of 1951 and was enacted with the purpose of establishing a new pension program. The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program.

Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

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

Under the new program the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

b. Funding Policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600, except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.275% of gross salary.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE M – RETIREMENT PLAN - continued

The Municipality's actual contribution for the current fiscal year, which is equal to the required contribution, follows:

<u>Fiscal Year</u>	<u>Law No. 447</u>	<u>2000 Reform</u>
2001-2002	\$ 277,427	\$ 135,462
2002-2003	272,677	138,427
2003-2004	265,904	142,549

NOTE N - MUNICIPAL SOLID WASTE LANDFILL CLOSURE AND POST CLOSURE CARE COST

The Municipality discontinued the operation and ceased to accept solid waste in its landfill since 1993. State and Federal laws and regulations require the Municipality to perform certain closure procedures and establish monitoring and maintenance function at the landfill for 30 years after closure. The closure care procedures were assumed and completed by the Municipality. In addition, the Municipality is also required to provide post-closure care costs after the closure activity is completed. Total estimated post-closure care costs have not been determined and accounted for as required by accounting principles generally accepted in the United States of America as of June 30, 2004.

NOTE O - CONTINGENCIES

1. Federal and state grants

Projects financed by federal and state grants are subject to audit in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to be performed.

2. Legal claims

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance. Other cases, except those described below, are pending and legal counsels have not determined an outcome. However, it is the opinion of the Municipality and the legal counsels that based on their experience such actions and the potential liabilities will not impair the Municipality's financial position. There is a probable loss amounting to \$23,240 in two cases that will be settled by legal counsels.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE P - COMMITMENTS

1. Construction:

The Municipality has active construction projects as of June 30, 2004. Total accumulated commitments for ongoing capital projects are composed of the following:

	<u>Committed</u>
General facilities	\$ 4,164,202
Park and recreation	856,766
Streets and drainage	<u>246,594</u>
Total	<u>\$ 5,267,562</u>

2. Operating leases:

Operating lease expense for the year amounted to \$9,592.

NOTE Q – FUND BALANCE AND NET ASSETS RESTATEMENTS

Fund balance of the debt service fund was restated to correct an overstatement of receivable from CRIM. Net assets as of July 1, 2003 have been restated to include transactions not recorded in previous years as follows:

<u>Description</u>	<u>Amount</u>	<u>Amount</u>
Net Assets at beginning of year as previously reported:		\$ 6,905,933
Adjustments:		
Correction of Debt Service Fund account receivable balance		(131,375)
Correction of accrued interest payable balance		(35,605)
Recognition of LIMS debt		(477,428)
Recognition of Christmas Bonus payable		(332,912)
Recognition of Christmas Bonus Reimbursement Receivable		154,627
Correction of beginning balance of capital assets and accumulated depreciation:		
Land and improvements	\$ 3,225,719	
Construction in Progress	(2,101,436)	
Building and improvements	13,945,627	
Equipment	(21,749)	
Roads	9,179,346	
Bridges	3,075,516	
Accumulated depreciation	<u>(9,746,165)</u>	17,556,858
Net Assets at beginning of year as restated:		<u>\$ 23,640,098</u>

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2004

NOTE R - SUBSEQUENT EVENTS

1. On July 6, 2004 the Government Development Bank of Puerto Rico (GDB) approved a \$455,000 loan to the Municipality for the acquisition of equipment.

NOTE S - SPECIAL ITEMS

1. Property tax amnesty

Law No. 74 of March 1, 2004 approved by the Commonwealth's Legislature (as amended by Law No. 131 of June 1, 2004) granted to taxpayers (for the period March 1, 2004 to June 30, 2004) an amnesty for payment of real and personal property tax debts. As a result, the CRIM distributed to the municipality \$423,062 on property tax collections as of June 30, 2004 of which \$ 307,432 were recorded in the general fund and \$ 115,630 recorded in the debt service fund. The CRIM applied \$ 17,710 on additional collections (included in the general fund) for the payment of principal of the line of credit agreement which was issued to finance delinquent property tax accounts sold to private investors under the provisions of Law No. 146 of October 11, 2001. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of Municipality's management.

2. Legal settlement with Puerto Rico Power Authority (PREPA)

On December 2000, the Municipality and other municipalities of Puerto Rico filed a complaint against the Puerto Rico Electric Authority (PREPA), a component unit of the Commonwealth of Puerto Rico, requesting the payment by PREPA of contribution in lieu of taxes and electric energy sales set aside on prior fiscal years. On March 18, 2003, the Board of Directors of PREPA approved a resolution by which PREPA agreed to settle the claims with all municipalities. Accordingly, the Municipality received \$ 893,514 in cash during fiscal year 2003-04 and will receive \$ 748,975 in construction projects. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of the Municipality's management.

3. Transfer of recreational and sport facilities

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

**Commonwealth of Puerto Rico
Municipality of San German
Required Supplementary Information -
Budgetary Comparison Schedule-General Fund
For the year ended June 30, 2004**

	<u>Budgeted amounts</u>		<u>Actual</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>amounts</u> <u>(budgetary basis)</u>	<u>final budget</u> <u>positive (negative)</u>
<u>Revenues</u>				
Property taxes	\$ 3,660,168	\$ 3,660,168	\$ 4,342,886	\$ 682,718
Municipal tax, licenses and permits	1,945,625	1,945,625	1,980,917	35,292
Intergovernmental	4,291,540	5,185,054	5,281,342	96,288
Rental income and charges for services	2,800,590	2,800,590	1,943,188	(857,402)
Fines and forfeitures	5,000	5,000	2,880	(2,120)
Interest	99,800	99,800	74,686	(25,114)
Other	310,000	379,773	1,498,339	1,118,566
Total revenues	13,112,723	14,076,010	15,124,238	1,048,228
<u>Expenditures</u>				
General government	4,226,333	4,548,827	4,475,441	73,386
Public safety	975,222	850,618	849,312	1,306
Public works	4,667,695	5,422,112	5,378,678	43,434
Sanitation	1,388,655	1,419,178	1,416,775	2,403
Health	747,339	747,340	747,339	1
Welfare	398,222	401,904	400,397	1,507
Culture and recreation	346,990	344,735	343,372	1,363
Education	362,267	355,783	353,363	2,420
Total expenditures	13,112,723	14,090,497	13,964,677	125,820
Excess (deficiency) of revenues over expenditures	<u>\$ -</u>	<u>(14,487)</u>	<u>1,159,561</u>	<u>1,174,048</u>
Other financial sources (uses)				
Transfers out		(610,363)	(604,325)	6,038
Total other financial sources (uses)		<u>(610,363)</u>	<u>(604,325)</u>	<u>6,038</u>
Net change in fund balance		(624,850)	555,236	1,180,086
Readjustment from prior year fund balance		<u>624,850</u>	<u>-</u>	<u>624,850</u>
		<u>\$ -</u>	<u>\$ 555,236</u>	<u>\$ 555,236</u>

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

COMMONWEALTH OF PUERTO RICO
Municipality of San German
NOTES TO BUDGETARY COMPARISON SCHEDULE
June 30, 2004

NOTE A - BUDGET POLICY

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981 as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at time the budget is prepared.

Budget amendments, are approved by the Municipal Legislature. Certain budget transfers within the limitations and restriction of the Autonomous Municipal Law can be approved by the Mayor or by the Municipal Legislature. The Budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchases orders, contracts) are considered expenditure when commitment is made. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statement as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of the current year. Encumbrance's appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapse at year end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenues funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternative achieved through general obligation bond indentures and legal contractual grant agreement provisions.

NOTE B - RECONCILIATION OF DIFFERENCES BETWEEN BUDGETARY BASIS TO GAAP

The Municipality's Combined Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds has been prepared in accordance with GAAP and the Budget Comparison Schedule - General Fund has been prepared on the budgetary basis, which is different from GAAP. The following reconciles the net change in fund balance:

Net change in fund balance (Budgetary basis)	\$ 555,236
Timing differences	
Current year encumbrances	486,747
Prior year encumbrances	(296,074)
Basis of accounting differences:	
Expenditures in GAAP not in Budget	(115,016)
Revenues in budget and not in GAAP	(12,043)
Expenditures in budget and not in GAAP	68,308
Net change in fund balance (GAAP basis)	<u>\$ 687,158</u>

SINGLE AUDIT SECTION

**Commonwealth of Puerto Rico
Municipality of San German
Schedule of Expenditures of Federal Awards
For the year ended June 30, 2004**

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number (note B)</u>	<u>Pass-Through Entity Identifying Number (note C)</u>	<u>Federal Expenditures (note A)</u>
<u>U.S. Department of Agriculture</u>			
Major program:			
Direct program:			
Community Facilities Loans and Grants	10.766	N/A	\$ 1,938,742
<u>U.S. Department of Commerce</u>			
Major program:			
Direct program:			
Grants for Public Works and Economic Development	11.300	N/A	810,270
<u>U.S. Department of Housing and Urban Development</u>			
Major programs:			
Passed through the Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - State's Program	14.228	AB - 57 FC - 57 FD - 57 FEM	1,413,590
Direct program:			
Section 8 Housing Choice Vouchers	14.871	N/A	388,241
			<u>1,801,831</u>
<u>U.S. Department of Justice</u>			
Non major program:			
Passed through the P.R. Department of Justice:			
Local Law Enforcement Block Grant	16.592	N/A	19,094
<u>U.S. Department of Transportation - National Highway Traffic Safety Administration</u>			
Non major program:			
Passed through the P.R. Department of Transportation - (Traffic Safety Commission):			
State and Community Highway Safety	20.600	03-03-76	12,282
<u>Institute of Museum and Library Services</u>			
Non major program:			
Passed through P.R. Department of Education			
State Library Program	45.310	P L. 104-208	5,704
<u>Federal Emergency Management Agency</u>			
Non major program:			
Passed through the Puerto Rico Governor's Office - (Governor's (Governor's Authorized Representative-GAR):			
Public Assistance Grants	83.544	125-99-125	22,900
<u>U.S. Department of Health and Human Services</u>			
Non major programs:			
Passed through the Puerto Rico Governor's Office - (Office of Elderly Affairs):			
Special Program for the Aging Title III Part B Grants for Supportive Services and Seniors Centers	93.044	N/AV	62,097
Passed through the " Instituto de Servicios Comunes Inc.(INSEC)"			
Community Services Block Grant	93.569	CSBG 03-04-32	12,748
			<u>74,845</u>
Total Expenditures of Federal Awards			<u>\$ 4,685,668</u>

The accompanying notes are an integral part of this schedule.

Commonwealth of Puerto Rico
Municipality of San German
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the year ended June 30, 2004

NOTE A – BASIS OF PRESENTATION

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

NOTE B – FEDERAL CFDA NUMBER

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

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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

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

Description	Other Governmental Funds
10.766	\$ 1,938,742
11.300	810,270
14.228	1,413,590
14.871	388,241
16.592	19,094
20.600	12,282
45.310	5,704
83.544	22,900
93.044	62,097
93.569	12,748
Total federal awards expenditures:	4,685,668
Total non-federal awards expenditures:	2,251,568
Total expenditures, fund statements:	<u>\$ 6,937,236</u>

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

*Mayor and Municipal Legislature
Municipality of San German
San German, Puerto Rico*

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of San German, Puerto Rico (the Municipality) as of and for the year ended June 30, 2004, and have issued our report thereon dated January 20, 2005 which is qualified since the Municipality has not determined and recorded in governmental activities an estimate of the total municipal solid waste landfill post closure care costs of a closed solid waste landfill, as required by accounting principles generally accepted in the United States of America. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

Compliance and Other Matters

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

We noted certain matters that we reported to management in a separate letter dated January 20, 2005.

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



Rodriguez, Rivera & Toro LLP

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

*Mayor and Municipal Legislature
Municipality of San German
San German, Puerto Rico*

Compliance

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

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

We were unable to obtain sufficient documentation supporting the compliance of the Municipality with *Grants for Public works and Economic Development* program regarding *Davis-Bacon Act and Reporting* requirements, as described in the accompanying schedule of findings and questioned costs as items **2004 III-4** and **2004 III-5**; and with *Community Development Block Grant - State's Program* regarding *Special tests and provisions - tests for compliance with accounting records (budgetary requirements)*, as described in the accompanying schedule of findings and questioned costs as item **2004 III-8**, nor were able to satisfy ourselves as to Municipality's compliance with those requirements by other auditing procedures.

As described in items 2004 III-7, 2004 III-9 and 2004 III-10, in the accompanying schedule of findings and questioned costs, the Municipality did not comply with the requirements regarding *Reporting and Special tests and provisions – tests to participant files of donation of construction materials* that are applicable to its *Community Development Block Grant - State's Program*. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

In our opinion, except for the effects of such compliance, if any, as might have been able to examine sufficient evidence regarding the Municipality's compliance with *Grants for Public works and Economic Development* program regarding *Davis-Bacon Act and Reporting* requirements and with *Community Development Block Grant - State's Program* regarding *Special tests and provisions – tests for compliance with accounting records (budgetary requirements)*, and except for the non-compliance described in the fourth paragraph, the Municipality of San German, Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2004.

Internal Control over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2004 III-1 to 2004 III-11.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2004 III-4, 2004 III-5, 2004 III-7, 2004 III-8, 2004 III-9, and 2004 III-10 to be material weaknesses.

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



Rodriguez, Rivera & Toro LLP

Mayer, Brown, P.L.L.C. 142
January 20, 2005, except for tests to major program *Grants for Public works and Economic Development*, as to which the date is March 24, 2005.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2004

Section I - Summary of Auditor's Results:

Part I - Financial Statements

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

Part II - Federal Awards

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

Identification of major programs:	<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
	10.766	Community Facilities Loans and Grants
	11.300	Grants for Public works and Economic Development
	14.228	Community Development Block Grant - State's Program
	14.871	Section 8 Housing Choice Vouchers

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 II-1
Area: Capital Assets
Type: Material Weakness

Criteria: The Municipality should establish internal control policies and procedures to assure that capital assets are properly accounted in order to maintain adequate and updated inventory records. Accounting principles generally accepted in the United States of America require capital assets to be properly identified, valued and recorded in the Municipality accounting records and accordingly, reported in the basic financial statements.

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

- (1). Land and improvements:
Land and improvements records included duplicated items and a significant donated asset not valued.
- (2). Construction in progress:
Construction in progress records disclosed inaccurate and unsupported project balances as of June 30, 2004.
- (3). Buildings and improvements:
Buildings and improvements records reported items erroneously capitalized, a significant asset not properly classified as construction in progress, several assets with unsupported costs and donated assets not properly valued.

Cause: During fiscal year 2003-2004, the Municipality performed a review of capital assets inventory records. But the Municipality has not established internal control procedures related to the review of inventory records to assure that items included in inventory records represent capital assets and/or properly valued and classified in order to be reported in the basic financial statements. In addition, established capitalization procedures related to donated assets were not properly followed.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 II-1 - continued

Effect:	Capital assets are the most significant assets of the Municipality and therefore, these exceptions could have a significant impact on the government wide statements. Matters disclosed were submitted to management for correction and were properly adjusted and corrected by management in the basic financial statements.
Recommendation:	The Municipality should establish proper internal control procedures to assure that capital assets inventory records include accurate data for recording in the basic financial statements, as required by accounting principles generally accepted in the United States of America. The finance department should assign properly trained personnel to record, maintain and review capital assets accounting records and follow proper capitalization policies, specially related to donated assets. Emphasis should be directed on controls over data gathering on construction projects in process.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-1
Agency: U. S. Department of Agriculture – Rural Development
Program: Community Facilities Loans and Grants
CFDA Number: 10.766
Project: Construction of Bridge
Regulation/Requirement: Davis-Bacon Act
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: As part of the requirements of the Davis-Bacon Act the contractor should submit to the non-federal entity weekly, for each week in which any contract is performed, a copy of the payroll and a statement of compliance (certified payrolls). The Municipality should establish procedures to verify and document payroll's review to determine that contractor is paying not less than prevailing wage rates as established in the construction contract.

Condition: There is no adequate evidence to support the contractor's payrolls review at the federal programs office.

Context: Our tests disclosed that there is a signature of a federal programs officer as evidence of review in 9 of 65 payrolls submitted by contractor.

Cause: The federal programs office has not followed established procedures to document payrolls reviews.

Effect: There is no adequate evidence to support the compliance of applicable requirement by the federal programs office. If this procedure is not properly done, contractor may pay at rates other than prevailing rates and not timely detected and corrected.

Recommendation: The federal programs office should properly document the performance of payrolls reviews with the signature of the applicable officer and the approval of the federal programs office director.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-2
Agency: U. S. Department of Agriculture – Rural Development
Program: Community Facilities Loans and Grants
CFDA Number: 10.766
Project: Construction of Bridge
Regulation/Requirement: Special Tests and Provisions - tests to accounting records for compliance with 7 CFR 3016.20 (b)
Type: Reportable condition
Questioned Costs: \$ -0-

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

Condition:

- a. Program general ledger maintained by the Federal Programs Office is incomplete and not balanced. Even though the Municipality maintains a parallel computerized accounting system, the amounts reported or accounted in the program manual general ledger system do not agree with general ledger of centralized accounting system.
- b. The employee in charge of accounting and reporting performed incompatible duties such as: preparation of bank conciliation and recording of purchase orders, vouchers for payments, request of funds, cash receipts in the program general ledgers as well as in the centralized accounting system.

Cause: The Municipality has not followed established procedures related to segregation of duties and supervision of accounting procedures performed at the federal programs office. Internal controls over recording and reconciliation of accounting records at the federal programs office are inadequate.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-2 - continued

Cause – continued: There is not an adequate review and reconciliation procedures of program transactions on a monthly basis between the federal programs office and the centralized computerized accounting system at the finance department.

Effect: Inadequate accounting records and improper segregation of duties, without formal and adequate reconciliation procedures between the federal programs office and the finance department, may cause the occurrence of errors and irregularities which may not be timely detected. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were properly verified and adjusted by personnel of the finance department.

Recommendation: A complete review of the program records should be performed to assure that all transactions are adequately posted. As part of this process, records should be reconciled with centralized accounting records and pass-through entity records. Personnel should be trained in accounting matters and verification controls should be established between the Federal Programs Office and the Finance Department. Accounting duties should be revised and segregated at the federal programs office to avoid the occurrence of errors and irregularities which may not be timely detected. The Municipality's Internal Auditor should perform tests to verify compliance with established internal control procedures.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-3
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction and rehabilitation of Rural Enterprise and Service Center – Award Number 01-01-07584
Regulation/Requirement: Cash management, 13 CFR 305.24(a)
Type: Reportable condition
Questioned Costs: \$ -0-

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

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

Context:

- a. Disbursements related to federal funds transfer of \$441,907 dated May 19, 2004 were made on May 20, 2004 for a total amount of \$399,521. Excess cash: \$42,386 from May 20 to June 11, 2004.
- b. Disbursement related to federal funds transfer of \$90,094 dated June 11, 2004 was made on July 9, 2004 for \$52,492. Excess cash: \$132,480 from June 11 to July 9, 2004 and \$79,988 from July 9 to July 21, 2004
- c. Next disbursement was made on July 21, 2004. This disbursement should have been financed in part with federal funds transfer of \$90,094. Instead, was financed with an interfund loan of \$94,500, keeping excess funds in bank account.

Cause: Program accounting controls were not adequate and there were no proper procedures established to review for determination of excess cash available.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number:

2004 III-3 - continued

Effect:

Excess cash in bank account which do not permit compliance with requirement to reduce time elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursement to construction contractor.

Recommendation:

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

Views of responsible officials and planned corrective actions:

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number:	2004 III-4
Agency:	U. S. Department of Commerce
Program:	Grants for Public Works and Economic Development
CFDA Number:	11.300
Project:	Construction and rehabilitation of Rural Enterprise and Service Center – Award Number 01-01-07584
Regulation/Requirement:	Davis-Bacon Act
Type:	Material weakness, material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria:

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or sub-contractor (if applicable) comply with the requirements of the Davis-Bacon Act and DOL regulations. In order to comply with this requirement the applicable clause and prevailing wages rates table should be included as part of construction contract. In addition, the contractor should submit to the non-federal entity weekly, for each week in which any contract is performed, a copy of the payroll and a statement of compliance (certified payrolls). The Municipality should establish procedures to verify and document payroll's review to determine that contractor is paying not less than prevailing wage rates as established in the construction contract.

Condition:

- a. There is no evidence that the required Davis-Bacon Act clause and the prevailing wages rates table were included as part of construction contract.
- b. There is no adequate evidence to support the contractor's payrolls review at the federal programs office.
- c. Certain payrolls were missing and the Statements of Compliance were not properly certified by the contractor.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-4 - continued

Condition – continued:	d. Documents included with the Statements of Compliance were enlarged copies of the payment stubs issued to the Company's workers in which the information given was the name, address and social security number of the employee; total hours worked; hourly rate; salary paid to date; employee withholdings and total accumulated vacations and sick leave. The worker's job position within the company (carpenter, electrician, plumber, etc.) was not indicated.
Context:	The contractor submitted 57 payrolls and we found that none of these payrolls had evidence of the required review by the Federal Program Department's personnel of the salary rates paid to their workers. We also noted that 4 payrolls were missing and 3 payrolls were not signed by the contractors' personnel certifying the Statement of Compliance as correct.
Cause:	The Municipality has not followed established procedures for compliance with applicable requirements.
Effect:	Since lack of information on contract and contractor's payrolls, contractor might have paid at rates other than prevailing rates and not timely detected and corrected. In addition, this situation prevented the application of auditing procedures and therefore, we were unable to obtain sufficient and competent evidence to support compliance with Davis-Bacon Act requirements applicable to this grant.
Recommendation:	The Federal programs office should assign personnel to perform tests to payrolls in order to determine if contractor is paying not less than applicable prevailing wage rates.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-5
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction and rehabilitation of Rural Enterprise and Service Center – Award Number 01-01-07584
Regulation/Requirement: Reporting
Type: Material weakness, material instance of noncompliance
Questioned Costs: \$ -0-

Criteria: As required by program regulations, the Municipality shall submit each quarter a financial status report (Form 269-A) including the financial activities related to project costs. This report should agree with data in grantee's accounting records.

Condition: Financial reports were not found and others tested do not agree with accounting data.

Context:

- a. The grantee was required to submit 4 reports applicable to fiscal period 2003-2004. There were no evidence of preparation and submission of reports related to quarter ending March 31, 2004 and June 30, 2004.
- b. Report on quarter ending September 30, 2003 showed no expenditures, since project commenced on October, 2003. Expenditures disclosed in report of quarter ending December 31, 2004 do not agree with accounting records data.

Cause: The federal programs office has not adequate accounting records and controls related to grant transactions.

Effect: The Municipality did not comply with applicable requirement. We were unable to perform adequate tests of compliance with reporting requirement.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

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

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

Condition:

- a. Program general ledger maintained by the Federal Programs Office is incomplete and not balanced. Even though the Municipality maintains a parallel computerized accounting system, the amounts reported or accounted in the program manual general ledger system do not agree with general ledger of centralized accounting system.
- b. The employee in charge of accounting and reporting performed incompatible duties such as: preparation of bank conciliation and recording of purchase orders, vouchers for payments, request of funds, cash receipts in the program general ledgers as well as in the centralized accounting system.

Cause: The Municipality has not followed established procedures related to segregation of duties and supervision of accounting procedures performed at the federal programs office. Internal controls over recording and reconciliation of accounting records at the federal programs office are inadequate.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-6 - continued

Cause – continued:	There is not an adequate review and reconciliation procedures of program transactions on a monthly basis between the federal programs office and the centralized computerized accounting system at the finance department.
Effect:	Inadequate accounting records and improper segregation of duties, without formal and adequate reconciliation procedures between the federal programs office and the finance department, may cause the occurrence of errors and irregularities which may not be timely detected. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were properly verified and adjusted by personnel of the finance department.
Recommendation:	A complete review of the program records should be performed to assure that all transactions are adequately posted. As part of this process, records should be reconciled with centralized accounting records and pass-through entity records. Personnel should be trained in accounting matters and verification controls should be established between the Federal Programs Office and the Finance Department. Accounting duties should be revised and segregated at the federal programs office to avoid the occurrence of errors and irregularities which may not be timely detected. The Municipality's Internal Auditor should perform tests to verify compliance with established internal control procedures.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number:	<u>2004 III-7</u>
Agency:	U. S. Department of Housing and Urban Development
Pass-through Entity:	Office of Commissioner of Municipal Affairs (OCAM)
Program:	Community Development Block Grant – State’s Program
CFDA Number:	14.228
Regulation/Requirement:	Reporting
Type:	Material weakness, material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria: Reports of federal awards submitted to federal awarding agencies or pass-through entities must include all activity of the reporting period, must be supported by underlying accounting or performance records and must be submitted within required dates. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub-grant. The Municipality is required to submit to the pass-through entity a quarterly report of the financial activities related to the grant.

Condition:

- a. Several accounts and data included in financial reports tested do not agree or do not reconcile with program’s general ledger.
- b. Certain program year’s budget accumulated balances and summary information per reports do not agree with the general ledger and pass-through entity’s balances.
- c. In 2 quarters there is no evidence of reports submission to the pass-through entity.
- d. Certain reports include footing errors which disclose that were not revised by applicable supervisory personnel.

Context: From a total population of 24 program year reports prepared for the year we tested 1 report for each quarter for a total of 4 reports. In 3 reports there were a significant number of accounts with differences with the general ledger. In one of the reports there were 1 or more expenditure accounts not included which were reported in the general ledger. In addition, this report does not include corrections and adjustments recorded in the general ledger.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-7 - continued

Context – continued:

In 1 of the quarterly reports tested the accumulated balances for administrative expenditures and budget available do not agree with the general ledger.

Differences with pass-through entity (OCAM) related to request of funds and budget available balances as of June 30, 2004 follows:

Accumulated funds requested:

<u>Program year</u>	<u>Per OCAM</u>	<u>Per Report</u>	<u>Difference</u>
1998	\$1,017,347	\$1,008,050	\$ 9,297
1999	1,180,647	1,171,863	8,784
2000	1,255,045	1,255,045	-
2001	1,030,815	1,013,724	17,091
2002	460,035	94,677	365,358
2003	757,171	636,491	120,680

Accumulated available funds:

<u>Program year</u>	<u>Per OCAM</u>	<u>Per Report</u>	<u>Difference</u>
1998	\$ 31,153	\$ 40,450	\$ (9,297)
1999	49,708	59,492	(9,784)
2000	8,484	8,484	-
2001	7,035	106,578	(99,543)
2002	771,805	205,323	(566,482)
2003	522,829	643,661	(120,832)

Cause:

The program accounting records are inadequate (see related Finding No. 2004 III-8). The Municipality has not followed established procedures to document timely submission of reports.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-7 - continued

Effect: The Municipality is not in compliance with applicable regulations related to program financial reporting.

Recommendation: A complete review of accounting records should be performed by personnel of the federal programs office in coordination with personnel of the pass-through entity (OCAM) in order to correct and conciliate accumulated report's balances. Reports should be submitted to the pass-through entity after a review and reconciliation with accounting records. The Municipality should assign specific personnel the responsibility of documenting reports submission. The Municipality's Internal Auditor should perform tests to verify compliance with established internal control procedures.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-8
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State’s Program
CFDA Number: 14.228
Regulation/Requirement: Special Tests and Provisions - tests to accounting records for compliance with 25 CFR 85.20(b)
Type: Material weakness, material instance of noncompliance
Questioned Costs: \$ -0-

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

Condition:

- a. Program general ledger maintained by the Federal Programs Office is incomplete and not balanced. Even though the Municipality maintains a parallel computerized accounting system, the amounts reported or accounted in the program manual general ledger system do not agree with general ledger of centralized accounting system.
- b. Budgetary information recorded in the program general ledgers is incomplete and transfers in and out do not balance.

Cause: Internal controls over recording and reconciliation of accounting records at the federal programs office are inadequate. There is not an adequate review and reconciliation procedures of program transactions on a monthly basis between the federal programs office and the centralized computerized accounting system at the finance department.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-8 - continued

Effect: Inadequate accounting records and lack of adequate reconciliation procedures between the federal programs office and the finance department may cause occurrence of errors and irregularities not timely detected. As a result, we were unable to perform adequate tests for compliance in individual accounts with budgetary requirements. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were properly verified and adjusted by personnel of the finance department by applying alternative procedures.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number:	2004 III-9
Agency:	U. S. Department of Housing and Urban Development
Pass-through Entity:	Office of Commissioner of Municipal Affairs (OCAM)
Program:	Community Development Block Grant – State’s Program
CFDA Number:	14.228
Regulation/Requirement:	Special Tests and Provisions - tests to participant files of donation of construction materials
Type:	Material weakness, material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria: The Municipality’s should comply with internal control policies and regulations to avoid possible conflicts of interest in relation with services and family relationship situations.

Condition:

- a. Our tests disclosed a case in which the Municipality’s employee in charge of performing the inspection visit to the participant’s home in order to determine the estimates for construction materials donation, has a family relationship with the participant. There is no evidence of evaluation and resolution on this kind of special situation by the personnel in charge of the Municipality’s citizen’s support and federal programs offices to comply with internal control policies related to possible conflicts of interest.
- b. As part of participant’s eligibility, the Municipality requests to the participant evidence of property ownership. The participant file includes a deed in relation to the land (but not the house) in which the property is located. There is no evidence of evaluation and conclusion by the Municipality’s citizen’s support and federal programs offices to determine that the employee who performed the inspection unit have or do not have any kind of ownership or financial interest in the unit or property under inspection.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-9 - continued

Cause:	The Municipality's personnel do not follow the internal control policies and regulations to avoid possible conflicts of interest in relation with services and family relationship situations. The municipal employee indicated that he is the only employee in charge of unit inspections in relation to determination of estimates for construction materials donation.
Effect:	The Municipality did not comply with applicable regulations.
Recommendation:	The Municipality should revise the internal control policies in relation construction materials donation and advise applicable personnel to detect and resolve possible instances of conflicts of interest. The Municipality's internal auditor should perform a detailed review of participant file and obtain additional information or evidence about participant's property ownership.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-10
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State’s Program
CFDA Number: 14.228
Regulation/Requirement: Special Tests and Provisions - tests to participant files of donation of construction materials
Type: Material weakness, material instance of noncompliance
Questioned Costs: \$ -0-

Criteria: The Municipality’s internal control policies include procedures to monitor the use of construction materials donated including site visits and time requirements. The participant is required to use and perform the unit improvements within 6 months after receipt of materials. The Municipality should perform a final site visit on or before the 6 month period and remove the materials if not used.

Condition: All participant files tested do not have evidence of follow-up or final visits as a monitoring procedure to determine final use of construction materials and the conclusion of unit improvements.
In addition, there are no adequate procedures related to unused materials removal and storing at the Municipality’s facilities.

Context: We tested a sample of 10 participant files from a population of 91. None of sample cases tested have evidence of follow-up or final inspection visits.

Cause: The Municipality is not following internal controls procedures and applicable compliance requirements related to monitoring of use of construction materials and have not established specific procedures for the storing of materials removed from participants. As a result, certain participants may have not used the donated materials which have not been picked up by applicable municipal personnel.

Effect: The Municipality did not comply with applicable regulations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-10 - continued

Recommendation:

The federal programs office employees in charge of unit's inspection should comply with internal controls procedures and applicable compliance requirements related to monitoring of use of construction materials. Specific procedures should be established for the management, accountability and storage of materials removed from participants. Inventory should be maintained on a perpetual record.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2004

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

Reference Number: 2004 III-11
Agency: U. S. Department of Housing and Urban Development
Program: Section 8 Housing Choice Vouchers
CFDA Number: 14.871
Regulation/Requirement: Special Tests and Provisions - tests to accounting records for compliance with 25 CFR 85.20(b)
Type: Reportable condition
Questioned Costs: \$ -0-

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

Condition: We examined the program general ledger maintained by the Federal Programs Office and noted that equity accounts may have no adequate balances. These accounts include unreserved surplus, cumulative HUD annual contributions, operating reserve and project fee account.

Cause: Errors in posting of closing entries are determined in the voucher for payment of annual contributions and operating statement.

Effect: Accounts contain erroneous balances which may lead to erroneous accounting and program determinations.

Recommendation: The grantee should revise, in communication with grantor agency, those equity account balances and post the applicable corrections in the general ledger. Personnel in charge of Section 8 program accounting should be trained on accounting matters and effect of final year adjusting and closing entries.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2004

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

Fiscal year ended June 30,	Finding No.	Condition	Status
2003	2003 II-1	The Municipality performed a review of the capital assets inventory records in order to comply with requirements of GASB Statement Number 34. The review was not completed on certain areas such as land and land improvements and buildings and building improvements, which are significant to the basic financial statements.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004. See related finding No. <u>2004 II-1</u> in the accompanying schedule of findings and questioned costs.
2003	2003 II-2	Our tests to a sample of 15 employees files (from a total population of 604 employees files) disclosed the following: <ol style="list-style-type: none"> 1. In 7 cases the computerized assistance record was not approved by the applicable and authorized employee. 2. Missing documentation from files. 	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004. On current year tests certain non significant documentation deficiencies were noted which were reported to management in a separate letter dated January 20, 2005.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

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

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-1	Our evaluation of the 39 quarterly reports submitted to the pass-through entity during the fiscal period disclosed the following: a. In 20 cases the Municipality could not provide evidence of timely submission. b. In 26 cases the amounts included in the reports do not reconcile with the amounts posted in the program general ledger	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004. See related finding No. 2004 III-7 in the accompanying schedule of findings and questioned costs.
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-2	Our tests to the program records and reports maintained by the Federal Programs Office of the Municipality disclosed the following: a. Program general ledgers maintained by the Federal Programs Office do no reconcile with centralized accounting records maintained by the Finance Department. There are significant differences between amounts reported in the accounting records maintained by both dependencies.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004. See related finding No. 2004 III-8 in the accompanying schedule of findings and questioned costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2004

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

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-2- Continued	<ul style="list-style-type: none"> b. Budgetary information recorded in the program general ledgers is incomplete and transfers in and out do not balance. c. Program general ledgers do not provide a proper cut-off of transactions pertaining to each fiscal year. 	
2002	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2002 III-1	Our tests to a sample of 10 participant's files of housing rehabilitation program financed with SBGP funds disclosed documents missing from the files.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated March 23, 2004.
2002	U.S. Department of HUD: Section 8 Housing Choice Voucher Program - CFDA Number 14.871	2002 III-2	Our tests to a sample of 24 participant's files of Section 8 program disclosed documents missing from the files.	Finding remains not cleared by grantor agency.



Estado Libre Asociado de Puerto Rico
Municipio Autónomo de San Germán



Oficina del Alcalde

Hon. Isidro Negrón Irizarry
Alcalde

**MANAGEMENT RESPONSE TO THE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Year ended June 30, 2004

II. Findings related to the financial statement reported in accordance with GAGAS:

Reference Number: 2004 II-1
Area: Capital Assets
Type: Material Weakness

Capital assets were included for the first time on the Municipality's June 30, 2004 Financial Statements and therefore we required additional technical support to correct certain aspects in the inventory records. The differences found by the auditors were corrected before the conclusion of the audit thus the capital assets ending balance was adjusted accordingly.

The municipality has establish a property unit, within the Finance Department and assigned sufficient personnel in charge of record keeping. This personnel is been trained to keep accurate capital assets inventory, to review existing records and on how to gather information supporting capital assets valuation. Also they were instructed to keep records of donated property.

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

Reference Number: 2004 III-1 and 4
Agency: US Department of Agriculture – Rural Development
Program: Community Facilities Loans and Grants
Agency: U.S. Department of Commerce
Program: Grants for Public Works and Economic Development
Regulation Requirement: Davis-Bacon Act

The Federal Program Director was instructed to document the review of the contractor's payrolls. The person performing the review must stamp and signed the document as reviewed and the director must approve the same.



*"Un Nuevo Amanecer
para San Germán"*

III. Federal Awards and Questioned Costs Reported in Accordance with OMB Circular A-133: (Continued)

Reference Number: 2004 III-1 and 4 (Continued)

The employee in charge of performing the review must perform test to contractor's payrolls in order to determine that the same is in compliance with the requirements of the Davis-Bacon Act.

Beside the Federal Program Direct, also the Municipal Secretary will be instructed to verify the contracts funded with Federal Grants to assure that all required clauses be included.

Reference Number: 2004 III-2
Agency: US Department of Agriculture – Rural Development
Program: Community Facilities Loans and Grants
Regulation Requirement: Special tests and provisions test to accounting records for compliance with 7 CFR 3016.20(b)

Procedures will be established to assure proper segregation of duties, that all transactions be accurately posted and, that internal manual records be reconciled with centralized accounting records. Also the assigned personnel has been instructed to perform and document the reconciliation process with the pass-through entity.

Reference Number: 2004 III-3
Agency: US Department of Commerce
Program: Grants for Public Works and Economic Development
Regulation Requirement: Cash Management

In order to avoid the time elapsing between the transfer of funds from the U. S. Treasury and the payment to suppliers, the Federal Program Director will establish measures to monitor that there is no excess cash in bank accounts.

Reference Number: 2004 III-5 and 6
Agency: US Department of Commerce
Program: Grants for Public Works and Economic Development
Regulation Requirement: Reporting

The Federal Program Director and personnel has been instructed to take the necessary measures to assure that:

Reference Number: 2004 III-5 and 6
Agency: US Department of Commerce
Program: Grants for Public Works and Economic Development
Regulation Requirement: Reporting

- The financial status reports be filed on a timely basis as required by federal regulations, and that the same must be accurate and reconciled with accounting records.
- To reconcile the general ledger kept at the program with the centralized accounting system.
- Accounting duties be segregated so that the employee in charge of record keeping do not perform reconciliation of bank accounts, request funds, and record payment voucher

Reference Number: 2004 III-7, 8 and 11
Agency: US Department of Housing and Urban Development
Program: Community Development Block Grant – State’s Program and Section 8 Housing Choice Vouchers
Regulation Requirement: Reporting

Since findings 7,8 and 11 are similar in nature we have grouped them together in our comments.

Management has been advised to:

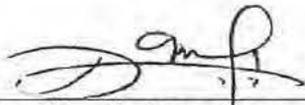
- Request support from the passthrough entity (OCAM) to reconcile the differences between our record and theirs.
- To review the program records to assure that all transactions are properly recorded
- To reconcile ledgers maintained at the program office with the centralized accounting system.
- To request from grantor agency (Section 8) the equity accounts balances and correct the same accordingly, and to seek training for the accounting personnel on year end adjusting and closing entries.

Reference Number: 2004 III-9 and 10
Agency: US Department of Housing and Urban Development
Program: Community Development Block Grant – State’s Program
Regulation Requirement: Special tests and provisions tests to participants files of donation of construction materials.

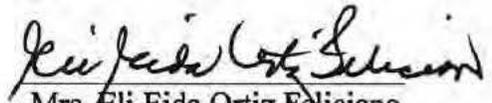
Management will advise personnel on how to avoid and detect possible instances of conflict of interest in donation of materials.

Reference Number: 2004 III-9 and 10 (Continued)
Agency: US Department of Housing and Urban Development
Program: Community Development Block Grant – State’s Program
Regulation Requirement: Special tests and provisions tests to participants files of donation of construction materials.

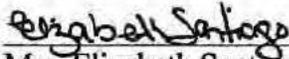
In relation to construction material donations management has instructed employees working in this area to strictly follow established internal controls and procedures, and to perform and document on recipients records follow-up or final inspection visits.



Ing. Damián Morales
Acting Mayor



Mrs. Eli Eida Ortiz Feliciano
Finance Director



Mrs. Elizabeth Santiago
Acting Federal Program Director