

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

MUNICIPIO DE SAN SEBASTIAN
AUDITORIA 2002-2003
30 DE JUNIO DE 2003

OPIC DEL COMISIONADO
DE CONTABILIDAD Y FINANZAS

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2003**

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

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MUNICIPALITY OF SAN SEBASTIÁN
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FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

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Services Division

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of San Sebastián
San Sebastián, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, discretely component unit, each major fund and the aggregate remaining fund information of the Municipality of San Sebastián, as of and for the year ended June 30, 2003, 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 did not audit the financial statements of Villa Soigal Project, as of June 30, 2003. Those financial statements were audited by other auditors whose report thereon has been furnished to, and our opinion, insofar as it relates to the amounts included for Villa Soigal Project, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the discretely presented component unit, each major fund and the aggregate remaining fund information of the Municipality of San Sebastián as of June 30, 2003, and the respective changes in financial position, thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2, the Municipality has implemented a new financial reporting model, as required by the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for States and Local Government."

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the basic financial statements, but is supplementary information required by the GASB. We have applied certain limited procedures, which consisted principally of inquires 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.

San Juan, Puerto Rico
October 24, 2003

The stamp 1908291 was affixed
to the original of this report.



Management Discussion and Analysis

As administrators of the Municipality of San Sebastián, (the Municipality) we offer the readers of the Municipality Financial Statements this analysis and narrative summary of the financial activities of the Municipality for the fiscal year ended on June 30, 2003. This discussion and analysis are intended to serve as an introduction to the Municipality's basic financial statements that are:

- (1) Government -wide Financial Statements**
- (2) Fund Financial Statements-Governments Funds**
- (3) Note's to the Basic Financial Statements**

This audit also contains other supplementary information that can be of interest to the readers of this audit. Please read these in conjunction with the financial statements that begin on page16.

Financial Highlights

- The assets of the Municipality exceed the liabilities as of the closing of the fiscal year ended on June 30, 2003 by \$3,478,001 (net assets). Of this quantity, \$10,846,874 (unrestricted net assets) was used to fulfill the obligations of the Municipality with the citizens and creditors, subject to certain legal requirements.
- The payment to the principal of the loans was \$725,000, reducing the balance of the long-term debt of \$9,125,000 in June 30, 2002 to \$8,400,000 in June 30, 2003.
- The investment in capital assets for this year is \$21,068,099, net of accumulated depreciation.
- During the year, the revenues were \$20,863,332, which, were used to cover the government expenses, representing this a surplus of \$458,485.

Introduction to the Financial Statements

The single audit corresponding to the **fiscal year 2002-03** includes the requirements established by the **GASB 34, 37 and 38**, which established substantial changes in the form of presenting the fiscal and financial situation of the Municipalities. This financial information is presented within the following:

- (1) Managements Discussion and Analysis** – This provides information on the Financial Statements and an analytic summary of the financial activities.
- (2) Government-wide Financial Statements** – These provide a broad overview of the Municipality's finances in a similar manner to a private business sector.

- (3) **Statements of Net Assets** - This presents information on all the Municipality's assets and liabilities with the two differences reported as net assets. Through this statement one can observe if the financial position of the Municipality has improved or deteriorated.
- (4) **Statements of Program Activities** - Presents the changes in the net assets of the Municipality during the most recent fiscal year. The government activities include general government, public safety, public works, culture, recreation, health and welfare as well as interest in long terms debts. The component unit (Villa Soigal Project) is reported separately from the financial information of the Municipality.
- (5) **Budgetary Comparison Schedules** - They present a reconciled comparison of the budget in accordance with **GAAP**.

Funds Financial Statements

This single audit presents the "***fund financial statement***" (begins on page 18) that include related accounts that are used to maintain control over resources that have been segregated by activities or specific objectives. The ***funds accounting*** has the purpose to assure and to demonstrate compliance with the legal requirements of the related financial activities. The basic services of the Municipality are reported in the governmental funds, which are focused in how much is available for expenses at the end of the year. These financial statements are reported using the method of accounting called "modified accrual", which measures cash and all other financial assets that can become cash. This statement details in concise form a vision of the governments' operations and of the services that it provides. In the same manner, it allows you to know if these financial resources more or less can be spent in the near future to finance the Municipal programs. This can be observed in the reconciliation presented on the page 20.

"***Notes to the financial statements***", as another element of the audit, provides additional information that is essential for a complete understanding of the data provided in the Government-wide and Funds Financial Statements.

Government-wide Financial Analysis

When we evaluate the Government-wide Financial Statements, we analyze the assets and the financial activities of the Municipality of San Sebastián. The "***net assets***" can be an indicator of the financial position of the Municipality. In our case, the assets exceed the liabilities by **\$3,478,001**, at the end of the fiscal year ended on June 30, 2003. (***See Table #1***)

Table #1

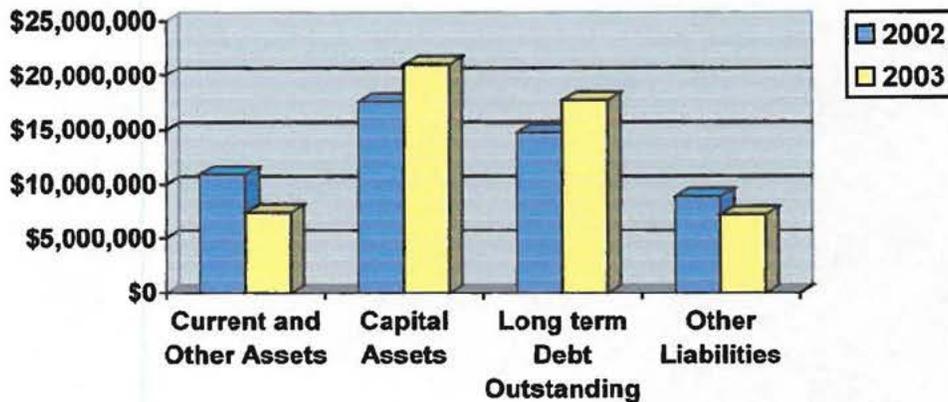
**Municipality of San Sebastián
Net Assets
June 30, 2003**

	Government Activities	
	Year 2002	Year 2003
Current and other assets	\$10,919,098	\$ 7,396,917
Capital Assets	17,636,997	21,068,099
Total Assets:	28,556,095	28,465,016
Long Term debt outstanding	14,788,856	17,761,946
Other liabilities	8,927,363	7,225,069
Total liabilities	\$23,716,219	\$24,987,015
Net Assets:		
Invested in Capital Assets	\$10,441,997	\$12,668,099
Net related debt		
Restricted for:		
Debt services	2,005,820	1,656,776
Unrestricted	(7,607,941)	(10,846,874)
Net Assets	<u>\$ 4,839,876</u>	<u>\$ 3,478,001</u>

The net assets of the government activities of the Municipality decreased by **\$1,361,875** compared with the previous year. Unrestricted net assets, the part of the net assets that is used to finance the daily operations without restrictions established by agreements, laws or other legal requirements, present a difference of \$1,361,875 approximately in June 30, 2003 (**\$3,478,001**) compared with June 30, 2002 (**\$4,839,876**). (See Diagram #1)

**Diagram #1
Municipality of San Sebastián
Composition of the Net**

Assets



Governmental Activities

The revenues of the government activities of the Municipality increased by **10% (\$2,285,403)**, while the expenditures increased 9%, representing **\$1,493,252**. To improve the financial position of the Municipality the following activities were carried out:

- The Director of the Finance Department sends every month to the directors of the different departments a Current Budget Statement to watch over significant fluctuations that can affect the fiscal situation of each department.
- Quarterly meetings with the Mayor are carried out to inform him of the fiscal operations, where he is explained about each account transaction and the status of the accounts payable and the expenses.
- Through these meetings, the Mayor and the Director of the Finance Department evaluate the reports of each department and determine the necessities of each one, searching to reduce expenses without affecting the services toward the citizens.

The increase in the **General Government Expenditures** during the fiscal year ended on June 30, 2003 is mainly related with the following:

- During that fiscal year salary increases were granted to the municipal employees. That created an impact to the general funds of approximately **\$486,880**.
- Christmas Bonus was increased, as required by a law approved by the Puerto Rico Legislature. This impact surpassed the **\$100,000**.
- A dramatic increase in the Public Insurance Area, representing a payment of more than **\$225,000** compared with the previous fiscal year.
- Several legal resources were presented for the collection of construction tax upon the negative of several companies of fulfilling their responsibilities. These resources are pending to be awarded and they represent more than **\$400,000**.

The Municipality's main sources of revenues are property and license tax, also, grants and contribution not restricted which represent 94% of all the revenues. The change in these three (3) categories was **\$2,899,335**.

The cost of all the activities of the fiscal year 2002-03 was \$17,826,645 compared with \$16,333,393.00 of last past year. (See Table #2 and Diagram #2)

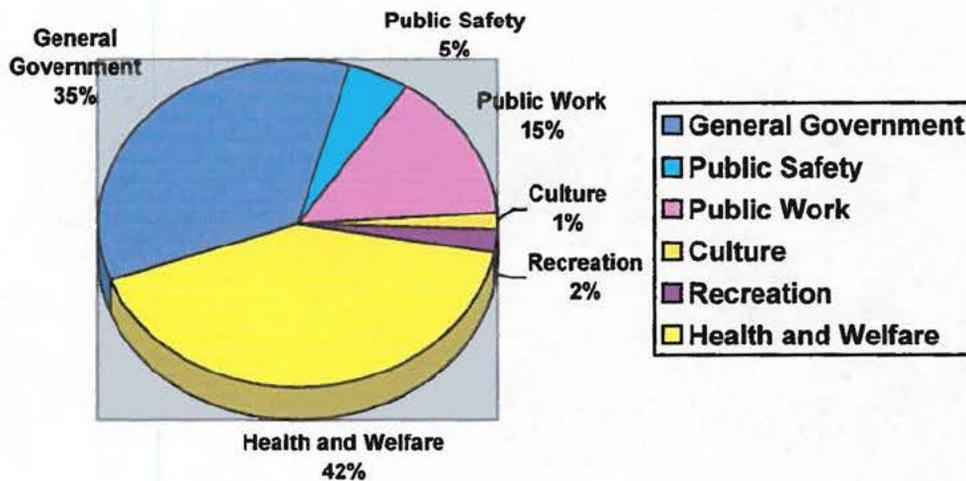
Table #2

**Municipality of San Sebastián
Governmental Activities**

	Total Cost of Services	
	Year 2002	Year 2003
General Government	\$ 6,809,047	\$ 6,172,942
Public Safety	859,577	885,152
Public Work	3,598,424	2,671,707
Culture	-0-	253,104
Recreation	328,854	393,271
Health and Welfare	5,737,491	7,450,463
Totals:	<u>\$16,333,393</u>	<u>\$17,826,645</u>

Diagram #2

2003 Governmental Activities Revenues



Financial Analysis of the Government Funds

Governmental Funds

The Municipality of San Sebastián uses the accounting of funds to assure and to demonstrate execution with the legal requirements of the financial transactions. The funds provide immediate information about the revenues and payments, and balances of the paid resources. Particularly, the unreserved funds balance can be used to measure the government's available resources to spend at the end of the fiscal year.

At the end of the year, the Municipality reported its "government fund" (like it is presented in the **Balance Sheet** on page 18) in a combined fund of \$828,229.

- The Municipality experienced a decrease in collection of license tax, governmental contribution and other revenues. Among the reasons for these changes are:
- Some trade stores of the Municipality closed operations, so we do not receive income from license tax.
- The state government made monthly adjustments to their remittances because they have not received the quantities they projected. These adjustments began on November 2002.

- The construction taxes were not collected as projected due to the contractors' resistance to pay them. (Pending court trials)

General Fund Budgetary Highlights

During the fiscal year, the Municipal Legislature approved resolutions amending the budget so that it reflected the current balances compared with the original budget. The Public Works Department received several transfers so that the services they offer were not affected. In the same manner, salaries and marginal benefits items were amended so that they would reflect the increases to the salaries granted during the month of January 2003.

Capital Assets

On June 30, 2003, the Municipality of San Sebastián invested **\$3.3 millions** in several construction projects (New Municipal Coliseum, Bridge over the Guatemala River, Child Care Project Building, Softball Park in the Cibao Ward). It was received from the State Government an assignment of **\$6.2 millions** to complete the construction of the New Municipal Coliseum. This resolution was approved by the State Legislature by means of the **Combined Resolution #659** and signed by the **Governor**. This payment will be issued through the Governments Development Bank and will be paid by State Government, not by the Municipality of San Sebastián. (See Table #3)

**Table #3
Municipio de San Sebastián
Long-Term Debt**

<u>Government Activities:</u>	Government Activities	
	2003	2002
Bonds Payable	\$ 8,400,000	\$ 9,130,000
Note Payable	1,088,786	-0-
Obligations under Capital Lease	271,912	398,369
Due to PR Treasury Develop.	47,104	111,364
Due to PR Labor Department	97,037	97,037
Compensated Absences	1,012,577	1,604,246
Claims and Judgments	-0-	116,220
Totals:----->	<u>\$10,917,416</u>	<u>\$11,457,236</u>
Component Unit:		
Villa Soigal Project Mortgage Payable	<u>\$ 1,515,214</u>	<u>\$ 1,563,226</u>

More details on the debt of the Municipality are on page 44.

Economic Factors and Next Year's Budget

For next fiscal year, the Municipality and their elected officials should consider several factors in the preparation of the budget. The tendency in the funds collected during the last years has been in ascent. The growth in the budget is between 3% and 7%, projection that can be reached in the next fiscal year: 2003-04.

The projection is subject to behavior of the economy, having unemployment near 26%. The expenses will behave according to the revenues, working with the daily operations of the Municipality.

Contacting the Municipality's Financial Management

The Financial Statements are prepared with the purpose that our citizens, taxpayers and creditors have a general vision of the financial situation of the Municipality of San Sebastián and to assume responsibility for the money that is received and the form in that it is used. Any doubt or question about this report or any additional financial information, you can write to Municipality of San Sebastián, PO Box 1603, San Sebastián, PR 00685 or calling at 1-787-896-1550.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF NET ASSETS
JUNE 30, 2003**

<u>Assets</u>	<u>Governmental Activities</u>	<u>Villa Soigal Project</u>
Cash in bank (Note 2)	\$ 3,706,652	\$ 25,264
Cash with fiscal agent (Note 2)	1,656,776	
Accounts receivables:		
Municipal license taxes (Note 7)	121,586	
Rent, licence and permits	122,371	
Other	3,724	1,630
Due from other agencies (Note 8)	1,785,808	
Restricted deposits		322,970
Other assets		21,039
Capital assets, net (Note 10)	<u>21,068,099</u>	<u>2,330,502</u>
 Total assets	 <u>\$ 28,465,016</u>	 <u>\$ 2,701,405</u>
 <u>Liabilities and Net Assets</u>		
Liabilities		
Bank overdraft	\$ 1,120,111	\$ -
Account payable and accrued liabilities	3,019,362	31,335
Due to other agencies (Note 11)	1,368,520	
Deferred revenues (Note 12):		
Municipal license tax	906,994	
Federal government	153,701	
Accrued interest	656,381	9,026
Noncurrent liabilities (Note 14):		
Due within one year	1,230,020	51,567
Due in more than one year	16,531,926	1,463,647
Total liabilities	<u>24,987,015</u>	<u>1,555,575</u>
Net Assets		
Investment in capital assets, net of related debt	12,668,099	
Restricted for:		
Debt service	1,656,776	
Unrestricted	<u>(10,846,874)</u>	<u>1,145,830</u>
Total net assets	<u>3,478,001</u>	<u>1,145,830</u>
 Total liabilities and net assets	 <u>\$ 28,465,016</u>	 <u>\$ 2,701,405</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Functions/Programs	Expenses	Program Revenues				Net (Expense) Revenue and Changes in Net Assets	
		Charges for Services	Licenses and Permits	Operating Grants and Contributions	Capital Grants and Contributions	Primary Governmental Activities	Component Unit Villa Soigal Project
Primary Government:							
General government	\$ 6,172,948	\$ 579,745	\$ 397,078	\$ -	\$ -	\$ (5,196,125)	\$ -
Public safety	885,152					(885,152)	
Public works	2,671,707				2,700,982	29,275	
Culture	253,104					(253,104)	
Recreation	393,271					(393,271)	
Health and welfare	7,450,463			5,590,404		(1,860,059)	
Depreciation	706,893					(706,893)	
Interest on long-term debt	656,381					(656,381)	
Total primary government	\$ 19,189,919	\$ 579,745	\$ 397,078	\$ 5,590,404	\$ 2,700,982	(9,921,710)	
Component Unit:							
Villa Soigal Project	\$ 593,832	\$ 502,502	\$ -	\$ -	\$ -		(91,330)
General revenues:							
Property taxes						4,967,503	
Municipal license tax						1,515,160	
Grants and contributions not restricted to specific programs						4,769,814	
Interest, fines and penalties						132,013	9,425
Miscellaneous						210,633	2,155
Total general revenues						11,595,123	11,580
Change in net assets						1,673,413	(79,750)
Net assets at beginning of year						1,804,588	1,225,580
Net assets at end of year						\$ 3,478,001	\$ 1,145,830

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2003**

<u>Assets</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Health and Human Services Programs</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Note 2)	\$ 410,116	\$ 125,473	\$ 626,374	\$ -	\$ 1,550,270	\$ 994,419	\$ 3,706,652
Cash with fiscal agent (Note 2)				1,656,776			1,656,776
Accounts receivable:							
Municipal license taxes (Note 7)	121,586						121,586
Rent, licenses and permits	122,371						122,371
Other		3,724					3,724
Due from other agencies (Note 8)	1,773,502	12,306					1,785,808
Due from other funds (Note 9)	576,368	384	8,599		883	1,550,270	2,136,504
Total assets	\$ 3,003,943	\$ 141,887	\$ 634,973	\$ 1,656,776	\$ 1,551,153	\$ 2,544,689	\$ 9,533,421

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2003**

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Health and Human Services Programs</u>	<u>Debt Service</u>	<u>Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities							
Bank overdraft	\$ 1,120,111	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,120,111
Account payable and accrued liabilities	2,362,390	10,649	320,290		166,346	159,687	3,019,362
Due to other funds (Note 9)	8,599	66,998	160,982		1,598,262	301,663	2,136,504
Due to other agencies (Note 11)	1,304,280	64,240					1,368,520
Deferred revenues (Note 12):							
Municipal license tax	906,994						906,994
Federal government			153,701				153,701
Total liabilities	<u>5,702,374</u>	<u>141,887</u>	<u>634,973</u>	<u>-</u>	<u>1,764,608</u>	<u>461,350</u>	<u>8,705,192</u>
Fund Balances (Deficit)							
Reserved for:							
Encumbrances	299,319				133,360	71,278	503,957
Debt service				1,656,776			1,656,776
Unreserved fund balance (deficit)	<u>(2,997,750)</u>				<u>(346,815)</u>	<u>2,012,061</u>	<u>(1,332,504)</u>
Total fund balance/(deficit)	<u>(2,698,431)</u>	<u>-</u>	<u>-</u>	<u>1,656,776</u>	<u>(213,455)</u>	<u>2,083,339</u>	<u>828,229</u>
Total liabilities and fund balance (deficit)	<u>\$ 3,003,943</u>	<u>\$ 141,887</u>	<u>\$ 634,973</u>	<u>\$ 1,656,776</u>	<u>\$ 1,551,153</u>	<u>\$ 2,544,689</u>	<u>\$ 9,533,421</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2003**

Total fund balances - governmental funds	\$ 828,229
Amounts reported for governmental activities in the statement of net assets are different because:	
• Capital assets, net, used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet	21,068,099
• Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. (Note 4)	(<u>18,418,327</u>)
Net assets of governmental activities	\$ <u>3,478,001</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

	General	Housing and Urban Development Programs	Health and Human Services Programs	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
REVENUES							
Property taxes (Note 6)	\$ 4,194,743	\$ -	\$ -	\$ 772,760	\$ -	\$ -	\$ 4,967,503
Municipal license taxes (Note 7)	1,515,160						1,515,160
Licenses and permits	397,078						397,078
Charges for service and rents	579,745						579,745
Intergovernmental revenues (Note 13):							
Federal grants and contributions		1,454,385	3,682,189			453,830	5,590,404
State contributions	3,823,288					3,647,508	7,470,796
Interest, fines, and penalties	116,413			15,428		172	132,013
Other revenues	210,633						210,633
Total revenues	<u>10,837,060</u>	<u>1,454,385</u>	<u>3,682,189</u>	<u>788,188</u>	<u>-</u>	<u>4,101,510</u>	<u>20,863,332</u>
EXPENDITURES							
Current:							
General government	5,466,444						5,466,444
Public safety	885,152						885,152
Public works	2,671,707						2,671,707
Culture	253,104						253,104
Recreation	393,271						393,271
Health and welfare	1,085,999	1,592,373	3,682,189			1,089,902	7,450,463
Capital outlays					1,908,620		1,908,620
Debt service:							
Principal retirement				807,820			807,820
Interest and other				568,266			568,266
Total expenditures	<u>10,755,677</u>	<u>1,592,373</u>	<u>3,682,189</u>	<u>1,376,086</u>	<u>1,908,620</u>	<u>1,089,902</u>	<u>20,404,847</u>
Excess (deficiency) of revenues over (under) expenditures	<u>81,383</u>	<u>(137,968)</u>	<u>-</u>	<u>(587,898)</u>	<u>(1,908,620)</u>	<u>3,011,608</u>	<u>453,495</u>
OTHER FINANCING SOURCES (USES)							
Transfers in	204,600	137,988		443,454	3,390,842	1,631,177	5,808,061
Transfers out	<u>(581,442)</u>	<u>-</u>		<u>(204,600)</u>	<u>(1,631,177)</u>	<u>(3,390,842)</u>	<u>(5,808,061)</u>
Total other financing sources (uses)	<u>(376,842)</u>	<u>137,988</u>	<u>-</u>	<u>238,854</u>	<u>1,759,665</u>	<u>(1,759,665)</u>	<u>-</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses	<u>(295,459)</u>	<u>-</u>	<u>-</u>	<u>(349,044)</u>	<u>(148,955)</u>	<u>1,251,943</u>	<u>458,485</u>
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	<u>(2,402,972)</u>			<u>2,005,820</u>	<u>(64,500)</u>	<u>831,396</u>	<u>369,744</u>
FUND BALANCE (DEFICIT) AT END OF YEAR	<u>\$ (2,698,431)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,656,776</u>	<u>\$ (213,455)</u>	<u>\$ 2,083,339</u>	<u>\$ 828,229</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Net change in fund balances - total governmental funds \$ 458,485

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

- 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 and reported as depreciation expense. 1,908,620
 - Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (706,893)
 - Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 807,820
 - Change in accrued interest expense which does not require the use of current financial resources. (88,115)
 - Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds. (706,504)
- Changes in net assets of governmental activities (\$1,673,413)

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

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ORTIZ, RODRIGUEZ, RIVERA & CO.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF REVENUES AND EXPENDITURES, BUDGET AND ACTUAL - GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

	General Fund				Debt Service Fund			
	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 3,564,555	\$ 3,564,555	\$ 3,564,555	\$ -	\$ 948,197	\$ 948,197	\$ 772,760	\$ (175,437)
Municipal license taxes	1,820,000	1,820,000	1,515,160	(304,840)				
Licenses and permits	425,000	425,000	397,078	(27,922)				
Charges for services and rent	700,000	700,000	579,745	(120,255)				
Intergovernmental revenues:								
State contributions	4,125,550	3,978,860	3,823,288	(155,572)				
Interest, fines and penalties	185,000	185,000	116,413	(68,587)			15,428	15,428
Other revenues	622,575	622,575	415,233	(207,342)				
Total revenues	<u>11,442,680</u>	<u>11,295,990</u>	<u>10,411,472</u>	<u>(884,518)</u>	<u>948,197</u>	<u>948,197</u>	<u>788,188</u>	<u>(160,009)</u>
EXPENDITURES								
Current:								
General government	5,819,034	5,835,887	5,933,580	(97,693)				
Public safety	1,037,464	930,829	885,152	45,677				
Public works	2,755,819	2,717,162	2,671,707	45,455				
Culture	480,736	276,524	253,104	23,420				
Recreation	350,762	404,591	393,271	11,320				
Health and welfare	998,865	1,130,997	1,085,999	44,998				
Debt service:								
Principal					476,346	476,346	807,820	331,474
Interest					471,851	471,851	568,266	96,415
Total expenditures	<u>11,442,680</u>	<u>11,295,990</u>	<u>11,222,813</u>	<u>73,177</u>	<u>948,197</u>	<u>948,197</u>	<u>1,376,086</u>	<u>427,889</u>
Excess of expenditures over revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (811,341)</u>	<u>\$ (811,341)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (587,898)</u>	<u>\$ (587,898)</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

1. ORGANIZATION

The Municipality of San Sebastián, Puerto Rico (Municipality) was founded in 1752. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

For fiscal year ended June 30, 2003, the Municipality implemented; GASB Statement No. 34 (GASB 34), Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments; GASB Statement No. 37 (GASB 37), Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus; and GASB Statement No. 38 (GASB 38), Certain Financial Statements Disclosures.

GASB 34, as amended by GASB 37, establishes new requirements and a new reporting model for the financial statements of state and local governments. GASB 34 was developed to make the financial statements easier to understand and more useful to the people who use governmental financial information to make decisions and includes:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

The financial information of the Municipality is presented in this report as follows:

- **Management's Discussion and Analysis** - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- **Government - Wide Financial Statements** - The new reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).
- **Statement of Net Assets** - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure. The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.
- **Statement of Program Activities** - The new government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- **Budgetary comparison schedules** - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the new reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

GASB 38 establishes and modifies disclosure requirements related to the summary of significant accounting policies, actions taken to address violations of significant finance - related legal and contractual provisions, debt and lease obligations, short-term debt, disaggregation of receivable and payable balances, and interfund balances and transfers with GASB 34 is implemented.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

The following is a summary of the more significant policies.

a. Reporting Entity

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, "The Financial Reporting Entity," of the GASB. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions.

The Villa Soigal Project is included in the basic financial statements as a discretely component unit because of the nature of the services they provide and the Municipality's ability to impose its will

Villa Soigal Project is a 120-unit multi-family housing project owned by the Municipality as authorized transfer from the Special Trustee for the Liquidation of the Accounts of the Puerto Rico Urban Renewal and Housing Corporation. The Project is operated under Section 515 of USDA, Rural Development (USDA-RD) and regulated by the U. S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreements with HUD, and a significant portion of the Project's rental income is received from HUD. Also, the Project is financed by a Mortgage of Section 515 Direct Loan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Municipality reports the following major governmental funds:

1) General Fund

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

2) Housing and Urban Development Programs (HUD Programs)

This fund account for revenue sources for the development of viable urban communities, decent housing, suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low-income family.

3) Health and Human Services Programs (HHS Programs)

This fund account for revenue sources to provide essential human services such as health insurance for elderly and low-income people, improving

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

maternal and infant health, pre-school education and services, prevent child abuse and domestic violence and medical and social science research including the prevention of outbreak of infections disease and immunization services.

4) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

5) Capital Projects Fund

This fund is used to account for the financial resources used for the acquisition and construction of major capital facilities, financed with the proceeds of general obligation bonds.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, licenses, permits, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. Interfund Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either due to/from other funds (i.e., the current portion of interfund loans) or advances to/from other funds (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as due to/from other funds.

f. Capital Assets

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

and maintenance are expensed as incurred. Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

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

1) Encumbrances

Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

2) Debt Service

Represents net assets available to finance future debt service payments.

3) Capital Projects Fund

Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2003 amounted to approximately \$468,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$288,000 for workers compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

j. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
39	Determining Whether Certain Organizations are Components Units	2003-04
40	Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements.	2004-05
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2004-05

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

3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

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

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2003 representing the original budget.

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing uses for the year ended June 30, 2003 is presented below for the general and debt service funds:

	<u>General</u>	<u>Debt Service</u>
Excess of expenditures over revenues - budgetary basis	(\$811,341)	(\$587,898)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

	<u>General</u>	<u>Debt Service</u>
Timing differences:		
Current year encumbrances recorded as expenditures on the budgetary basis	\$299,319	\$ -
Entity differences:		
Non-budgeted transfers	-	223,426
Non-budgeted revenues	<u>216,563</u>	<u>15,428</u>
Excess of expenditures over revenues - GAAP basis	<u>(\$295,459)</u>	<u>(\$349,044)</u>

c. Legal Compliance

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

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$12 million difference are as follows:

Bonds payable	\$ 8,400,000
Landfill obligation	6,252,861
Compensated absences	1,604,246
Note payable	1,088,786
Accrued interest payable	656,381
Obligation under capital leases	271,912
Other long-term liabilities	<u>144,141</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$18,418,327</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

5. DEPOSITS

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$499,000 in the general fund were fully collateralized at June 30, 2003. In addition, the HUD Programs, HHS Programs and other governmental funds, maintain deposits with commercial banks of approximately \$137,000, \$268,000 and \$238,000 respectively, that were fully collateralized.

The deposits at GDB of approximately \$1.5 million that are restricted principally for capital projects, and the \$1.7 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its investments in two (2) banks located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

The rates are 8.08% for real property and 5.08% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	< .20% >	< .20% >
	<u>8.08%</u>	<u>5.08%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. During July 2002, the Municipality entered into a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001 for approximately \$1.1 million. This amount will be repaid through advances from property taxes (refer to Note 14).

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2002-03, but not the final settlement as the six months period after fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2003, the amount collected from taxpayers and charges by CRIM of approximately \$6.0 million, less than the advances received by the Municipality for the same period by \$445,838. Such amount is presented as intergovernmental receivable in the general fund in the basic financial statements.

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2003. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of San Sebastián, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of San Sebastián, are as follows:

Savings and loans associations	= 1.00%
Financial institutions	= 1.50%
Other organizations:	
Up to \$500,000	= .40%
Over \$500,000	= .50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$906,000, corresponding to the next fiscal year municipal license.

8. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power of Authority	\$1,327,664
Municipal Revenues Collection Center	445,838
HUD - Section 8	<u>12,306</u>
	<u>\$1,785,808</u>

9. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2003, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Other Governmental Funds	Capital Projects	\$1,550,270
General	Other Governmental Funds	300,396
General	HHS Programs	160,982

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	HUD Programs	\$ 66,998
General	Capital Projects	47,992
HHS Programs	General	8,599
Capital Projects	Other Governmental Funds	883
HUD Programs	Other Governmental Funds	<u>384</u>
		<u>\$2,136,504</u>

The balance of \$1,550,270 due to the other governmental funds from the capital projects fund represents cash held by other governmental funds in the name of the capital projects fund.

All remaining balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2003 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Capital Projects	Other Governmental Funds	\$3,390,842
Other Governmental Funds	Capital Projects	1,631,177
Debt Service	General	443,454
General Fund	Debt Service	204,600
HUD Programs	General	<u>137,988</u>
		<u>\$5,808,061</u>

The transfer from other governmental funds to the capital projects fund of \$3,390,842, represents monies received for the construction of the Municipal Coliseum, which were received through other governmental funds. In addition, the transfer from the Capital Projects fund of \$1,631,177, mainly represents the costs incurred in connection with the construction of the Municipal Coliseum.

**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
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Remaining transfers are used to (1) move revenues from the fund that statute or budget revenues to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the fund collection the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

10. CAPITAL ASSETS

Capital asset activity for the Municipality for the year ended June 30, 2003 was as follows:

<u>Primary Government</u>	<u>Balance July 1, 2002 (As Restated)</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2003</u>
Governmental Activities:				
Capital assets, not being depreciated:				
Land	\$ 2,021,116	\$ -	\$ -	\$ 2,021,116
Construction in progress	7,728,773	3,319,547	-	11,048,320
Total capital assets, not being depreciated	<u>9,749,889</u>	<u>3,319,547</u>	<u>-</u>	<u>13,069,436</u>
Capital assets, being depreciated:				
Buildings and building improvements	7,507,539	325,569	-	7,833,108
Furniture and fixtures	2,063,024	250,256	3,825	2,309,455
Vehicles and equipment	3,515,460	246,446	-	3,761,906
Infrastructure	1,274,124	-	-	1,274,124
Total capital assets, being depreciated	<u>14,360,147</u>	<u>822,271</u>	<u>3,825</u>	<u>15,178,593</u>
Less accumulated depreciation for:				
Buildings and building improvements	1,517,431	185,262	-	1,702,693
Furnitures and fixtures	1,711,916	190,641	-	1,902,557
Vehicles and equipment	3,031,271	305,508	-	3,336,779
Infrastructure	212,419	25,482	-	237,901
Total accumulated depreciation	<u>6,473,037</u>	<u>706,893</u>	<u>-</u>	<u>7,179,930</u>
Total capital assets, being depreciated, net	<u>7,887,110</u>	<u>115,378</u>	<u>3,825</u>	<u>7,998,663</u>
Governmental activities capital assets, net	<u>\$ 17,636,999</u>	<u>\$ 3,434,925</u>	<u>\$ 3,825</u>	<u>\$ 21,068,099</u>

**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

The beginning balance of capital assets at July 1, 2002 has been restated to conform with the adoption of GASB 34.

Capital asset activity for Villa Soigal Project, a discretely presented component unit, for the year ended June 30, 2003 was as follows:

<u>Component Unit- Villa Soigal Project</u>	<u>Balance July 1, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2003</u>
Capital assets, not being depreciated:				
Land	\$ 58,350	\$ -	\$ -	\$ 58,350
Total capital assets, not being depreciated	<u>58,350</u>	<u>-</u>	<u>-</u>	<u>58,350</u>
Capital assets, being depreciated:				
Land improvements	739,624			739,624
Buildings and building improvements	3,566,155			3,566,155
Building equipment	338,529	70,037		408,566
Furniture and fixtures	30,646	900		31,546
Equipment	8,648	1,250		9,898
Total capital assets, being depreciated	<u>4,683,602</u>	<u>72,187</u>	<u>-</u>	<u>4,755,789</u>
Less accumulated depreciation for:				
Land improvements	375,976	18,491		394,467
Buildings and building improvements	1,783,185	93,351		1,876,536
Building equipment	136,470	38,421		174,891
Furnitures and fixtures	25,743	3,103		28,846
Equipment	8,730	167		8,897
Total accumulated depreciation	<u>2,330,104</u>	<u>153,533</u>	<u>-</u>	<u>2,483,637</u>
Total capital assets, being depreciated, net	<u>2,353,498</u>	<u>(81,346)</u>	<u>-</u>	<u>2,272,152</u>
Villa Soigal Project capital assets, net	<u>\$ 2,411,848</u>	<u>\$ (81,346)</u>	<u>\$ -</u>	<u>\$ 2,330,502</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

11. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2003 are as follows:

Puerto Rico Electric Power Authority	\$1,132,986
Puerto Rico Water and Sewer Authority	87,698
U. S. Department of Housing and Urban Development	64,240
Retirement System Administration	57,665
General Services Administration	16,496
U. S. Internal Revenue Services	<u>9,435</u>
Total	<u>\$1,368,520</u>

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately \$907,000 in the general fund related to municipal license tax collected in fiscal year 2002-03 that will be earned in fiscal year 2003-04.

b. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant. The balance of \$153,701 in the HHS Programs is related to the Head Start Program.

13. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

14. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2003 are as follows:

Bonds

\$3,420,000 series of 1996, payable in annual installments of \$70,000 to \$315,000 until July 1, 2016, interest ranging from 4.7% to 6.875%.	\$2,810,000
\$1,010,000 series of 1996, payable in annual installments of \$20,000 to \$95,000 until July 1, 2015, interest ranging from 4.7% to 6.58%.	815,000
\$1,800,000 series of 1997, payable in annual installments of \$20,000 to \$165,000 until July 1, 2021, interest ranging from 6.69% to 8.00%.	1,670,000
\$2,270,000 series of 1999, payable in annual installments of \$150,000 to \$315,000 until July 1, 2007, interest ranging from 6% to 8%.	1,325,000
\$655,000 series of 2000, payable in annual installments of \$115,000 to \$150,000, until July 1, 2004; interest ranging from 7.08% to 7.50%.	290,000
\$1,510,000 series of 2001, payable in annual installments of \$20,000 to \$135,000, until July 1, 2026; interest ranging from 5% to 8%.	<u>1,490,000</u>
Total bonds payable	<u>\$8,400,000</u>

Other Long-Term Liabilities

Labor Department, payable in monthly installments of \$4,043 until June 30, 2004.	\$48,519
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Due to the Treasury Department, payable in monthly installments of \$2,800 and final payment of \$974 until June 30, 2004.	\$31,774
Due to the Treasury Department, payable in monthly installments of \$2,555 until December 2003.	<u>15,330</u>
Total other long-term liabilities	<u>\$95,623</u>

Note Payable

Note payable of \$1,088,786 represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate principal installments of \$81,444 plus interest rate of 6.158%.

Due to Puerto Rico Health Insurance Administration

Due to the Puerto Rico Health Insurance Administration represents the municipal contribution related to the Health Care Reform corresponding to the period from December 1, 1995 through June 30, 1997. This balance will be paid through amounts retained by the CRIM from the participation in the Municipal Equalization Fund of the Additional Lottery System.

Obligations under Capital Leases

The Municipality of San Sebastián is obligated under capital lease for equipment as follow: Lease payable to AA Public Finance Co., Inc., payable in semiannual installments of \$64,551 (including interest at 7.5%) collateralized by a garage.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

The annual debt service requirements for the bonds payable and note payable at June 30, 2003, are as follows:

	<i>Bonds</i>		<i>Note Payable</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 575,000	\$ 559,596	\$ 14,395	\$ 67,049
2005	630,000	516,892	15,282	66,162
2006	525,000	475,936	16,223	65,221
2007	565,000	437,418	17,222	64,222
2008	590,000	395,690	18,282	63,162
2009-2013	1,855,000	1,609,007	109,751	297,469
2014-2018	2,205,000	862,303	147,969	259,249
2019-2023	995,000	355,407	199,498	207,720
2024-2028	460,000	79,200	268,972	138,247
2029-2032			281,192	44,583
	<u>\$ 8,400,000</u>	<u>\$5,291,449</u>	<u>\$ 1,088,786</u>	<u>\$ 1,273,084</u>

The minimum future lease payments under capital leases are as follows:

<u>Period Ending June 30,</u>	<u>Garage</u>
2004	\$129,102
2005	129,102
2006	<u>64,550</u>
	322,754
Less amount representing interest	(<u>50,842</u>)
	<u>\$271,912</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Component Unit

The mortgage payable by the discretely component unit is owed by Villa Soigal Project and consists of a 8% mortgage note, payable in monthly installments of \$13,203, including interest, until 2019, collateralized with land and building.

The principal maturities of the mortgage in each of the next five years and thereafter are as follows:

<u>Year Ended June 30,</u>	<u>Amount</u>
2004	\$ 51,567
2005	55,384
2006	59,484
2007	63,888
2008	68,618
Thereafter	<u>1,216,273</u>
	<u>\$1,515,214</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

Long-term liability activity for the year ended June 30, 2003 was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
Governmental Activities:					
Bonds payable	\$ 9,130,000	\$ -	\$ 730,000	\$ 8,400,000	\$ 575,000
Note payable		1,102,346	13,560	1,088,786	14,395
Obligations under capital lease	398,369		126,457	271,912	99,366
Total long-term debt	<u>9,528,369</u>	<u>1,102,346</u>	<u>870,017</u>	<u>9,760,698</u>	<u>688,761</u>
Other long-term liabilities:					
Landfill obligation	6,447,861		195,000	6,252,861	204,750
Due to Puerto Rico Treasury Department	111,364		64,260	47,104	47,104
Due to Puerto Rico Labor Department	97,037			97,037	97,037
Compensated absences	1,012,577	706,504	114,835	1,604,246	192,368
Claims and judgements	116,220		116,220		
Total other long-term liabilities	<u>7,785,059</u>	<u>706,504</u>	<u>490,315</u>	<u>8,001,248</u>	<u>541,259</u>
Total noncurrent liabilities, governmental activities	<u>\$ 17,313,428</u>	<u>\$ 1,808,850</u>	<u>\$ 1,360,332</u>	<u>\$ 17,761,946</u>	<u>\$ 1,230,020</u>
Component Unit:					
Villa Soigal Project mortgage payable	<u>\$ 1,563,226</u>	<u>\$ -</u>	<u>\$ 48,012</u>	<u>\$ 1,515,214</u>	<u>\$ 51,567</u>

15. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the ACT 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

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

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon 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 rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2003 was approximately \$322,000 million. The Municipality's payroll for employees covered by ERS was approximately \$3.5 million. The Municipality total payroll for all employees was approximately \$7.6 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2003, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

16. RISK MANAGEMENT

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

17. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place and Transportation center under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2003 was approximately \$106,000.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

Leasing arrangements with the Municipality as lessee:

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

18. MUNICIPAL SOLID WASTE LANDFILL POSTCLOSURE

The Municipality discontinued its landfill operations and ceased to accept solid waste in January 1993. State and Federal laws and regulations require the Municipality to perform certain postclosure procedures on its solid waste landfill after discontinuing

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

of operations and perform certain maintenance and monitoring functions at the landfill site for thirty years. Postclosure care procedures were assumed by Municipality and directed by an external consultant. The closure process was completed in January 17, 1997. The total estimated liability for postclosure care costs has been determined in approximately \$6.3 million as of June 30, 2003. (See Note 14).

19. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.
- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that it is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

20. COMMITMENTS

The Municipality of San Sebastián had several outstanding or planned construction projects as of June 30, 2003. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$296,000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)		
Section 8 - Rental Voucher Program	14.855	\$ 556,169
Pass-through Commissioner Office of Municipal Affairs - Community Development Block Grants/State Program - SBGP	14.228	<u>1,036,204</u>
Subtotal U.S. Department of HUD		<u>1,592,373</u>
U.S. Department of Health and Human Services (HHS)		
Pass through Governor's Office of Child Services and Community Development: Head Start	93.600	3,495,845
Pass through Administration of Families and Children: Child Care and Development Block Grant	93.575	<u>186,344</u>
Subtotal U.S. Department of HHS		<u>3,682,189</u>
U.S. Department of Agriculture		
Pass-through Education Department: Child and Adult Care Food Programs	10.558	<u>459,104</u>
Subtotal U.S. Department of Agriculture		<u>459,104</u>
TOTAL		<u>\$5,733,666</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of San Sebastián and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Expenditures as per basic financial statements:	
Housing and Urban Development Programs	\$1,592,373
Health and Human Services Programs	3,682,189
Included within other governmental funds	<u>459,104</u>
Total expenditures per schedule of expenditures of federal awards	<u>\$5,733,666</u>



ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
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Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

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

To the Honorable Mayor
and Municipal Legislature
Municipality of San Sebastián
San Sebastián, Puerto Rico

We have audited the basic financial statements of the Municipality of San Sebastián as of and for the year ended June 30, 2003, and have issued our report thereon dated October 24, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of San Sebastián's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect of 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 test disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Municipality of San Sebastián's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal

control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Municipality of San Sebastián, in a separate letter dated October 24, 2003.

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

San Juan, Puerto Rico
October 24, 2003

The stamp 1908292 was affixed
to the original of this report.



Ortiz, Rodriguez & Co



ORTIZ, RODRIGUEZ, RIVERA & CO.
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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH
REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Honorable Mayor
and Municipal Legislature
Municipality of San Sebastián
San Sebastián, Puerto Rico

Compliance

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

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality of San Sebastián'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 Municipality of San Sebastián' compliance with those requirements.

In our opinion, Municipality of San Sebastián complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 03-01 and 03-02.

Internal Control over Compliance

The management of Municipality of San Sebastián 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 Municipality of San Sebastián'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 in 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 Municipality of San Sebastián'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 03-2, 03-4, and 03-5.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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

We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

San Juan, Puerto Rico
October 24, 2003

The stamp 1908293 was affixed
to the original of this report



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expresses an unqualified opinion on the basic financial statements of the Municipality of San Sebastián.
- b. There were no reportable conditions on internal controls.
- c. No instances of noncompliance material to the financial statements of Municipality of San Sebastián were disclosed during the audit.
- d. There were no reportable conditions on internal controls over major programs.
- e. The auditor's report on compliance with requirements applicable to federal award programs for Municipality of San Sebastián express an unqualified opinion.
- f. Audit findings relative to the major federal award programs for the Municipality of San Sebastián are reported in number 3 of this schedule.
- g. The programs tested as major programs included:
 - 1) Head Start - CFDA No. 93.600
 - 2) Early Head Start - CFDA No. 93.600
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of San Sebastián was determined to be a low-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
<p>Head Start Early Head Start CFDA No. 93.600</p>	<p>Condition 03-1</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p> <p><u>Criteria</u></p> <p>The 45CFR 74.22(a) establishes that the federal funds recipient will adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.</p> <p><u>Cause</u></p> <p>The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.</p> <p><u>Effect</u></p> <p>The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>									
	<p style="text-align: center;"><u>Recommendation</u></p> <p>The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.</p>										
<p>Head Start CFDA No. 93.600</p>	<p>Condition 03-2</p> <p>The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis. During our examination of the Federal Cash Transaction Reports, we noted that the Municipality did not submit on time the quarterly reports for the following periods:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;"><u>Quarter Ended</u></th> <th style="text-align: center;"><u>Date Submitted</u></th> <th style="text-align: center;"><u>Due Date</u></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">12-31-02</td> <td style="text-align: center;">03-05-03</td> <td style="text-align: center;">01-15-03</td> </tr> <tr> <td style="text-align: center;">03-31-03</td> <td style="text-align: center;">05-27-03</td> <td style="text-align: center;">04-15-03</td> </tr> </tbody> </table> <p><u>Criteria</u></p> <p>The Municipality is not in compliance with 45 CFR 74.52 (1) (2) (111) which requires that the recipients submit the original and two copies of the Federal Cash Transaction Report fifteen (15) calendar days following the end of each quarter.</p>	<u>Quarter Ended</u>	<u>Date Submitted</u>	<u>Due Date</u>	12-31-02	03-05-03	01-15-03	03-31-03	05-27-03	04-15-03	<p>\$ <u>-0-</u></p>
<u>Quarter Ended</u>	<u>Date Submitted</u>	<u>Due Date</u>									
12-31-02	03-05-03	01-15-03									
03-31-03	05-27-03	04-15-03									

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p><u>Cause</u></p> <p>The above situation occurred because the Municipality did not ensure to verify and understand its reporting requirements for this program.</p> <p><u>Effect</u></p> <p>The continued failure to file the required reports may result in sanctions by the federal grantor, such as grant payment withholdings.</p> <p><u>Recommendation</u></p> <p>The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIÁN
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

The Municipality has not prior year findings.

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ORTIZ, RODRIGUEZ, RIVERA & CO.

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EXHIBIT I

CORRECTIVE ACTION PLAN

2

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CORRECTIVE ACTION PLAN

2003

Cognizant or Oversight Agency for Audit:

Municipality of San Sebastián respectfully submits the following corrective action plan for the year ended June 30, 2003.

Name and address of independent public accounting firm: Ortiz, Rodríguez, Rivera & Co., Suite 152, P O Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2003

The findings from the June 30, 2003

The findings from the June 30, 2003 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS – FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Finding 03-1: Head Start; Early Head Start – CFDA 93.600

Reportable Condition: See Condition 03-1

Recommendation

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

Action Taken

The Program Director is evaluating the actual process for requesting funds to establish new procedures of forecasting needs in order to correct or minimize failures to comply with cash management requirements.

Finding 03-2: Head Start – CFDA 93.600

Reportable Condition: See Condition 03-2

Recommendation

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

Action Taken

The Municipality's management is developing a tracking system which reminds program personnel of when reports are due and that they should keep adequate evidence of the submitted of all reports.

If the Cognizant or Oversight Agency for Audit has questions regarding the plan, please call Mr. Eric Castro, Finance Director, at (787) 896-2300.

Sincerely yours,



Eric Castro Hernández
Finance Director