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AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL
AREA DE ARCHIVO DIGITAL

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

COMISION DE LICITACION
MUNICIPALIDAD DE VIEQUES
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2004**

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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Suite 152, P.O. Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8324, Fax (787) 274-0562

PART I - FINANCIAL SECTION

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



ORTIZ, RODRIGUEZ, RIVERA & CO.
CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis O. Rivera Zúñiga

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

INDEPENDENT AUDITORS' REPORT

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

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

Except for the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material 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.

As discussed in Note 20, to the financial statements, management has not recorded a provision for liability of closure and postclosure care costs of the landfill. Accounting principles generally accepted in the United States of America require that a provision for liability of closure and postclosure care costs be recorded to comply with applicable state and federal regulations. The amount by which this departure would affect the liabilities, net assets, and expenses of the governmental activities is not reasonable determinable.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the Municipality of Vieques as of June 30, 2004, and the changes in financial position thereof for the year then ended.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund and the aggregate remaining fund information of the Municipality of Vieques as of June 30, 2004, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the basic financial statements, the Municipality of Vieques 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 State and Local Governments, as of June 30, 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2005, on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

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

San Juan, Puerto Rico
January 7, 2005

The stamp 2000977 was affixed
to the original of this report.



Ortiz Rodriguez, Rivera & Co

ORTIZ, RODRIGUEZ, RIVERA & CO.

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

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

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

FINANCIAL HIGHLIGHTS

- The Municipality's in the Governmental Activities has reported assets and net assets amounting to **\$94,516,730** and **\$85,863,129** respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to **\$85,384,388 (90 percent of total Municipality's assets)**.
- The Municipality in the same activities has reported total liabilities amounting to **\$8,653,601** in the accompanying statement of net assets, of which the most significant liabilities are bonds, notes and other long-term debt amounting to **\$6,770,593 (78 percent of total liabilities)**.
- The Municipality has reported total revenues amounting to **\$19,903,242** in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Gubernamental Funds, for the Fiscal Year Ended **June 30, 2004**. The most significant revenues amounting in this statement are property taxes and municipal licenses taxes and, licenses and permits were to **\$1,033,003 (5 percent of total revenues)** and **\$803,942 (4 percent of total revenues)**, respectively.
- The Municipality has reported a excess of revenues over expenditures amounting to **\$2,373,768** in the accompanying statement of revenues, expenditures and changes in fund balances – general fund.
- The Municipality's governmental funds reported combined ending fund balances of **\$7,549,873** which represent the fund balances of the general fund, capital projects funds and debt service fund combined (**all known as the Municipality's major funds**).
- The Municipality has reported unreserved fund balance for the general fund amounting to **(\$3,342,337)**.

- The Municipality has reported excess of revenues and other financing sources over expenditures and other financing uses amounting to **\$6,687,328** in the governmental funds. Such amount, correspond to General Fund, debt service and capital projects fund. As a significant fact, the Municipality's outlays for capital projects during the year amounted **\$3,469,803** while to the disponible funds provine of the fund balance available at beginning of the fiscal year. Such outlays over financing sources and reducing the expected income for the incongruence on the State economy were the principal reasons of the deficiency in the governmental funds.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

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

Government-Wide Financial Statements

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

Statement of Net Assets

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

Statement of Activities

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

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

Fund Financial Statements

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

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

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

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

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

For financial reporting purposes the Municipality has four major funds: **(1)** the General Fund, **(2)** Housing and Urban Development Program, **(3)** Capital Projects Fund and **(4)** the Debt Service Fund.

Notes to the Basic Financial Statements

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

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of: **(1)** a combining financial statements referred in connection to nonmajor governmental funds is presented, and **(2)** a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

Government-wide Financial Statements Summary

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, assets exceeded liabilities by **\$85,863,129 at June 30, 2004**.

As previously discussed, by far the largest portion of the Municipality's net assets reflect its investment in capital assets (e.g., land, buildings, machinery, equipment and all other property), less any related debt used to acquire those assets that is still outstanding. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. The following is a condensed presentation of the Municipality's financial position and results of operations, as reported in the government-wide financial statements:

Condensed Statement of Net Assets:

	<u>June 30, 2004</u>
Current assets	\$ 9,132,342
Capital assets	<u>85,384,388</u>
Total assets	<u>\$94,516,730</u>
Current liabilities	1,989,437
Non-current liabilities	<u>6,664,164</u>
Total liabilities	<u>\$ 8,653,601</u>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	84,124,388
Restricted	10,892,210
Unrestricted	<u>(9,153,469)</u>
Total net assets	<u>\$85,863,129</u>

An additional portion of the Municipality's net assets (3 percent) represents resources that are subject to restrictions on how they may be used. At the end of the current fiscal year, the Municipality has reported positive balances in two categories of net assets.

Condensed Statement of Activities:

	<u>June 30, 2004</u>
Revenues:	
Program revenues:	
Charges for services	\$ 823,582
Operating grants and contributions	2,013,972
Capital grants and contributions	6,188,975
General revenues:	
Property taxes	1,033,003
Municipal license taxes	180,060
Grants and contributions	6,823,786
Interest, fines and penalties	13,675
Miscellaneous	<u>2,826,189</u>
Total Revenues	<u>\$19,903,242</u>

Expenses:

General government	\$ 5,992,122
Public safety	598,418
Public works	5,053,327
Culture	422,592
Health and welfare	1,189,176
Depreciation expense	726,431
Interest on long-term debt	300,539
Total expenses	<u>\$14,282,605</u>

Change in net assets	5,620,637
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Net assets – at beginning of year	<u>80,242,492</u>
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Net assets – at end of year	<u>\$85,863,129</u>
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Fund Financial Statements Summary

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

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

Condensed Balance Sheet – Governmental funds:

	<u>June 30, 2004</u>
Total Assets – Major Funds	\$13,484,515
Total Assets – Nonmajor Funds	9,722
Total assets	<u>\$13,494,237</u>
Total Liabilities – Major Funds	\$ 5,934,642
Total Liabilities – Nonmajor Funds	9,722
Total liabilities	<u>\$ 5,944,364</u>
Fund Balances – Major Funds	\$ 7,549,873
Fund Balances – Nonmajor Funds	-----0-----
Total Fund Balance	<u>\$ 7,549,873</u>

Condensed Statement of Operations – Governmental funds:

Total Revenues – Major Funds	\$19,903,242
Total Revenues – Nonmajor Funds	<u>0</u>
Total revenues	<u>\$19,903,242</u>
Total expenditures – Major Funds	\$13,595,914
Total expenditures – Nonmajor Funds	<u>0</u>
Total expenditures	<u>\$13,595,242</u>
Other financing sources (uses) Major	380,000
Other financing sources (uses) Nonmajor	-0-
Revenues Over Expenses – Major	6,687,328
Revenues Over Expenses – Nonmajor	-0-
Total Ending Fund Balance	<u>\$ 7,549,873</u>

Financial Contact

The Municipality's financial statements are designed to present users (**citizens, taxpayers, customers, investors and creditors**) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 2nd floor of the **Vieques City Hall, Vieques, Puerto Rico.**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
STATEMENT OF NET ASSETS
JUNE 30, 2004**

<u>Assets</u>	<u>Governmental Activities</u>
Cash (Note 2)	\$ 8,305,777
Cash with fiscal agent (Note 2)	425,067
Due from other agencies (Note 8)	401,498
Capital assets, net (Note 10)	<u>85,384,388</u>
 Total assets	 <u>\$ 94,516,730</u>
 <u>Liabilities and Net Assets</u>	
Liabilities	
Account payable and accrued liabilities	\$ 292,774
Due to other agencies (Note 11)	697,982
Deferred revenues (Note 12):	
Municipal license tax	270,620
Federal government	321,093
Accrued interest	300,539
Noncurrent liabilities (Note 14):	
Due within one year	182,015
Due in more than one year	6,588,578
Total liabilities	<u>8,653,601</u>
Net Assets	
Investment in capital assets, net of related debt	84,124,388
Restricted for:	
Debt service	374,389
Capital projects	10,517,821
Unrestricted	<u>(9,153,469)</u>
 Total net assets	 <u>\$ 85,863,129</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
General government	\$ 5,992,122	\$ 823,582	\$ -	\$ -	\$ (5,168,540)
Public safety	598,418				(598,418)
Public works	5,053,327			6,188,975	1,135,648
Culture	422,592				(422,592)
Health and welfare	1,189,176		2,013,972		824,796
Depreciation	726,431				(726,431)
Interest on long-term debt	300,539				(300,539)
Total primary government	\$ 14,282,605	\$ 823,582	\$ 2,013,972	\$ 6,188,975	(5,256,076)
General revenues:					
Property taxes					1,033,003
Municipal license tax					180,060
Grants and contributions not restricted to specific programs					6,823,786
Interest, fines and penalties					13,675
Miscellaneous					2,826,189
Total general revenues					10,876,713
Change in net assets					5,620,637
Net assets at beginning of year					80,242,492
Net assets at end of year					\$ 85,863,129

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Assets</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash (Note 2)	\$ 1,717,124	\$ 333,977	\$ -	\$ 6,244,954	\$ 9,722	\$ 8,305,777
Cash with fiscal agent (Note 2)			374,389	50,678		425,067
Due from other agencies (Note 8)	241,391	160,107				401,498
Due from other funds (Note 9)	139,706			4,222,189		4,361,895
Total assets	\$ 2,098,221	\$ 494,084	\$ 374,389	\$ 10,517,821	\$ 9,722	\$ 13,494,237

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Liabilities and Fund Balance (Deficit)</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities						
Account payable and accrued liabilities	\$ 262,851	\$ 29,923	\$ -	\$ -	\$ -	\$ 292,774
Due to other funds (Note 9)	4,222,189	139,706				4,361,895
Due to other agencies (Note 11)	684,898	13,084				697,982
Deferred revenues: (Note 12)						
Municipal license tax	270,620					270,620
Federal government		311,371			9,722	321,093
Total liabilities	<u>5,440,558</u>	<u>494,084</u>	<u>-</u>	<u>-</u>	<u>9,722</u>	<u>5,944,364</u>
Commitments and Contingencies (Notes 18 and 19)						
Fund Balances (Deficit)						
Reserved for:						
Encumbrances	268,859					268,859
Debt service			374,389			374,389
Capital projects				10,517,821		10,517,821
Deficit	(3,611,196)					(3,611,196)
Total fund balance (deficit)	<u>(3,342,337)</u>	<u>-</u>	<u>374,389</u>	<u>10,517,821</u>	<u>-</u>	<u>7,549,873</u>
Total liabilities and fund balance (deficit)	<u>\$ 2,098,221</u>	<u>\$ 494,084</u>	<u>\$ 374,389</u>	<u>\$ 10,517,821</u>	<u>\$ 9,722</u>	<u>\$ 13,494,237</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2004**

Total fund balances - governmental funds	\$ 7,549,873
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	85,384,388
▪ 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>(7,071,132)</u>
Net assets of governmental activities	<u>\$ 85,863,129</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General	Housing and Urban Development Programs	Debt Service	Capital Project	Total Governmental Funds
REVENUES					
Property taxes (Note 6)	\$ 791,951	\$ -	\$ 241,052	\$ -	\$ 1,033,003
Municipal license taxes (Note 7)	130,000				180,060
Licenses and permits	803,942				803,942
Charges for service and rents	19,640				19,640
Intergovernmental revenues (Note 13):					
Federal grants and contributions		2,013,972			2,013,972
State contributions	6,823,786			6,188,975	13,012,761
Interest, fines, and penalties	11,370		2,305		13,675
Other revenues	2,826,189				2,826,189
Total revenues	<u>11,456,938</u>	<u>2,013,972</u>	<u>243,357</u>	<u>6,188,975</u>	<u>19,903,242</u>
EXPENDITURES					
Current:					
General government	5,612,109				5,612,109
Public safety	598,418				598,416
Public works	1,957,798				1,957,798
Culture and recreation	422,592				422,592
Health and welfare	567,213	621,963			1,189,176
Capital outlays		1,392,009		2,077,794	3,469,803
Debt service:					
Principal retirement			112,414		112,414
Interest and other			233,604		233,604
Total expenditures	<u>9,158,130</u>	<u>2,013,972</u>	<u>346,018</u>	<u>2,077,794</u>	<u>13,595,914</u>
Excess (deficiency) of revenues over (under) expenditures	<u>2,298,808</u>	<u>-</u>	<u>(102,661)</u>	<u>4,111,181</u>	<u>6,307,326</u>
OTHER FINANCING SOURCES (USES)					
Loan proceeds	380,000				380,000
Transfers in	2,214		307,254		309,468
Transfers out	(307,254)		(2,214)		(309,468)
Total other financing sources (uses)	<u>74,960</u>	<u>-</u>	<u>305,040</u>	<u>-</u>	<u>380,000</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses	<u>2,373,768</u>	<u>-</u>	<u>202,379</u>	<u>4,111,181</u>	<u>6,687,328</u>
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	<u>(5,716,105)</u>	<u>-</u>	<u>172,010</u>	<u>6,406,640</u>	<u>862,545</u>
FUND BALANCE (DEFICIT) AT END OF YEAR	<u>\$ (3,342,337)</u>	<u>\$ -</u>	<u>\$ 374,389</u>	<u>\$ 10,517,821</u>	<u>\$ 7,549,873</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
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, 2004**

Net change in fund balances - total governmental funds \$ 6,687,328

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. 374,274
- Depreciation expense on capital assets is reported in the statement of activities, but do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (726,431)
- Governmental funds report issuance of long-term debt as other financial sources because provides current financial resources. (380,000)
- 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. 112,414
- Change in accrued interest expense which does not require the use of current financial resources. (66,935)
- 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. (380,013)

Changes in net assets of governmental activities \$ 5,620,637

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL-GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

	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	\$ 599,443	\$ 729,316	\$ 791,951	\$ 62,635	\$ 176,122	\$ 176,122	\$ 241,052	\$ 64,930
Municipal license taxes	390,844	390,844	301,358	(89,486)				
Licenses and permits	763,858	763,858	803,942	40,084				
Charges for services and rent	50,000	50,000	19,640	(30,360)				
Intergovernmental revenues:								
State contributions	4,173,246	5,973,246	6,823,786	850,540				
Interest, fines and penalties	10,000	10,000	11,370	1,370			2,305	2,305
Other revenues	855,000	(92,988)	459,749	552,737				
Total revenues	<u>6,842,391</u>	<u>7,824,276</u>	<u>9,211,796</u>	<u>1,387,520</u>	<u>176,122</u>	<u>176,122</u>	<u>243,357</u>	<u>67,235</u>
EXPENDITURES								
Current:								
General government	3,248,300	3,532,509	5,121,556	(1,589,047)				
Public safety	418,604	780,597	598,419	182,178				
Public works	2,284,885	2,502,958	1,916,282	586,676				
Culture and recreation	233,630	350,130	422,593	(72,463)				
Health and welfare	656,972	658,082	567,212	90,870				
Debt service:								
Principal					103,930	103,930	112,414	(8,484)
Interest					72,192	72,192	233,604	(161,412)
Total expenditures	<u>6,842,391</u>	<u>7,824,276</u>	<u>8,626,062</u>	<u>(801,786)</u>	<u>176,122</u>	<u>176,122</u>	<u>346,018</u>	<u>(169,896)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 585,734</u>	<u>\$ 585,734</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (102,661)</u>	<u>\$ (102,661)</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. ORGANIZATION

The Municipality of Vieques, Puerto Rico (Municipality) was founded in 1844. 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 12 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, 2004, 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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** - This 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 statements 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.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

majority of the entity's governing body, and if either one of the following conditions exists: the primary government can impose its will on the other entity or the potentials exist 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. Based on the aforementioned criteria, the Municipality has no component units.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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*. 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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) 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.

4) Capital Project 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.

5) Special Communities Fund

This fund accounts for reserve sources for improvements and construction of housing projects for low-income people.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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.

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 and certificates of deposit 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 VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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 VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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, 2004 amounted to \$189,774. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$162,852 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. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board 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>
40	Deposit and Investment Risk Disclosures	2004-05
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2004-05
43	Financial Reporting for Post-employment Benefit Other than Pension Plans	2005-06

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
44	Economic Condition Reporting: The Statistical Section - an amendment on NCGA Statement I	2005-06
45	Accounting and Financial Reporting for Employers for Post-employment Benefits Other than Pensions	2009-10

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

k. 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.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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.

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.

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 deficiency of revenues under expenditures for the year ended June 30, 2004 is presented below for the general fund:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

	General Fund
Excess of revenues over expenditures - budgetary basis	\$ 344,342
Entity differences:	
Non-budgeted transfers in	2,214
Non-budgeted transfers-out	(307,254)
Non-budgeted revenues	2,904,772
Timing differences:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	(220,758)
Current year encumbrances recorded as expenditures for budgetary basis	268,859
Basis of accounting differences:	
Net change in receivables	52,988
Net change in account payable	(157,828)
Net change in deferred revenues	60,059
Net change in due to agencies	(<u>573,626</u>)
Deficiency of revenues over expenditures - GAAP basis	(<u>\$2,373,768</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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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 \$7 million difference are as follows:

Note payable	\$3,856,363
Bonds payable	1,260,000
Compensated absences	380,013
Accrued interest payable	300,539
Other liabilities	<u>1,274,217</u>
 Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	 <u>\$7,071,132</u>

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 collaterals 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 balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2004. Risk categories are described as follows:

Category 1: Deposit is insured or collateralized with securities held by the Secretary of the Treasury's agents in the Municipality's name.

Category 2: Deposit is collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Category 3: Deposit is uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

The Municipality's bank balances in commercial bank of approximately \$9 million in the governmental activities were fully collateralized at June 30, 2004 (Category 1). The deposits at GDB of approximately \$50,678 that are restricted principally for capital projects, and the \$374,390 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks (Category 3).

The Municipality maintains its deposits in one (1) bank 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 VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The rates are 8.03% for real property and 6.03% 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	1.20%	1.20%
Discounts made by state to tax payer	< .20% >	< .20% >
	<u>8.03%</u>	<u>6.03%</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 VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2003-04, but not the final settlement as the six months period after a 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, 2004, the amount received in advances from CRIM exceeded the amount collected from taxpayers and charges by CRIM for the same period by approximately \$29,000. Such amount is presented as intergovernmental payable in the general fund in the basic financial statements. (Refer to Note 11).

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, 2004. 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 Vieques, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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 Vieques, are as follows:

Financial institutions	=	1.5%
Other organizations	=	.4%

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 \$270,620, 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 Authority	\$241,391
U.S. Department of Housing and Urban Development	<u>160,107</u>
Total	<u>\$401,498</u>

9. INTERFUND TRANSACTIONS

a. Due from/to Other Funds:

The due from and due to other fund balances as of June 30, 2004, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Capital Project	General Fund	\$4,222,189
Special Communities Fund	General Fund	3,076,000
General Fund	HUD Programs	<u>139,706</u>
Total		<u>\$7,437,895</u>

The balance of \$4,222,189 due to the capital project fund from the general fund and the \$3,076,000 due to the Special Communities fund from the general fund represents cash held by the general fund in the name of the capital project fund and the Special Communities Fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2004 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
General	Debt Service	\$ 2,214
Debt Service	General	<u>307,254</u>
 Total		 <u>\$309,468</u>

The transfer from the general fund to the debt service fund of \$307,254 represents funds used for the payment of debt service as become due.

10. CAPITAL ASSETS

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

	<u>Balance July 1, 2003 (As Restated)</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2004</u>
Capital assets, not being depreciated:				
Land	\$ 65,290,252	\$ -	\$ -	\$ 65,290,252
Total capital assets, not being depreciated	<u>65,290,252</u>	<u>-</u>	<u>-</u>	<u>65,290,252</u>
Capital assets, being depreciated:				
Buildings and building improvements	25,119,519	209,400		25,328,919
Furniture and fixtures	1,156,359	92,039		1,248,398
Vehicles and equipment	1,062,488	72,835		1,135,323
Infrastructure	30,000			30,000
Total capital assets, being depreciated	<u>27,368,366</u>	<u>374,274</u>	<u>-</u>	<u>27,742,640</u>
Less accumulated depreciation for:				
Buildings and building improvements	5,024,852	611,700		5,636,552
Furnitures and fixtures	917,496	76,726		994,222
Vehicles and equipment	970,725	37,255		1,007,980
Infrastructure	9,000	750		9,750
Total accumulated depreciation	<u>6,922,073</u>	<u>726,431</u>	<u>-</u>	<u>7,648,504</u>
Total capital assets, being depreciated, net	<u>20,446,293</u>	<u>(352,157)</u>	<u>-</u>	<u>20,094,136</u>
Governmental activities capital assets, net	<u>\$ 85,736,545</u>	<u>\$ (352,157)</u>	<u>\$ -</u>	<u>\$ 85,384,388</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The beginning balance of capital assets at July 1, 2003 has been restated to conform with the adoption of GASB 34.

11. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2004 are as follows:

Puerto Rico Electric Power Authority	\$466,130
State Insurance Fund Corporation	127,015
Puerto Rico Employee's Retirement System	44,545
Municipal Revenues Collection Center	28,576
U. S. Department of Housing and Urban Development	13,084
Puerto Rico Department of Labor	9,913
Puerto Rico Ports Authority	7,025
Puerto Rico Water and Sewer Authority	<u>1,694</u>
Total	<u>\$697,982</u>

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of \$270,620 in the general fund related to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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. These were related to the following federal programs/grants:

Program/Grant Description

Section 8 Housing Voucher (HUD)	\$311,155
State Block Grant Program (HUD)	216
Other governmental funds	<u>9,722</u>
Total	<u>\$321,093</u>

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.

14. LONG-TERM DEBTS

Bonds and notes payable and other debts outstanding at June 30, 2004 are as follows:

Bonds

\$720,000 series of 1999, payable in semiannual installments ranging from \$10,000 to \$65,000 until July 1, 2023, excluding interest of 7%.	\$ 640,000
\$655,000 series of 2002, payable in semiannual installments ranging from \$5,000 to \$50,000 until July 1, 2026, excluding interest of 6%.	<u>620,000</u>
Total bonds	<u>\$1,260,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Notes

\$283,000 series of 1991, payable in quarterly installments of \$3,640, until October 1, 2011, excluding interest of 5%.	\$ 105,560
\$837,000 series of 2002, payable in semiannual installments ranging from \$12,400 to \$72,700, until July 1, 2026, excluding variable interest.	799,800
\$380,000 series of 2003, payable in semiannual installments ranging from \$5,000 to \$30,000, until July 1, 2029, excluding variable interest.	375,000
\$2,597,475 property tax advance, payable in semiannual installments of \$95,748, until July 1, 2032, including interest of 6.1876%.	2,533,007
\$1,289,867 non-interest bearing property tax advance, payable in annual installments of \$7,166 until July 1, 2010.	<u>42,996</u>
Total notes	<u>3,856,363</u>
Total bonds and notes	<u>\$5,116,363</u>

Note Payable

Note payable of \$2,533,007 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 semiannual aggregate principal installments of \$95,748 plus an interest rate of 6.1876%.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The annual debt service requirements for the bonds payable and advances from CRIM at June 30, 2004, are as follows:

	<i>Bonds</i>		<i>Note Payable</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 30,000	\$ 70,979	\$ 76,429	\$ 229,560
2006	35,000	69,732	79,847	231,991
2007	35,000	68,146	88,405	227,308
2008	35,000	66,492	92,310	221,879
2009	40,000	64,771	96,374	216,309
2010-2014	245,000	289,777	486,650	992,488
2015-2019	335,000	212,162	625,704	839,398
2020-2024	410,000	97,884	872,673	607,255
2025-2029	95,000	8,120	921,925	311,719
2030-2033	-	-	516,045	57,320
	<u>\$ 1,260,000</u>	<u>\$ 948,063</u>	<u>\$ 3,856,362</u>	<u>\$ 3,935,227</u>

As described in Note 6, the Municipality levies an annual special tax of 1.25% of the assessed value of real property. The proceeds of this tax are required to be credited to the Debt Service Fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected and retained by the CRIM.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<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	\$ 1,290,000	\$ -	\$ (30,000)	\$ 1,260,000	\$ 30,000
Note payable	<u>3,558,777</u>	<u>380,000</u>	<u>(82,414)</u>	<u>3,856,363</u>	<u>76,429</u>
Total long-term debt	<u>4,848,777</u>	<u>380,000</u>	<u>(112,414)</u>	<u>5,116,363</u>	<u>106,429</u>
Due to PR Health Insurance					
Administration	644,333	-	-	644,333	
Claims and judgements	380,013			380,013	
Compensated absences	<u>629,884</u>			<u>629,884</u>	<u>75,586</u>
Total other liabilities	<u>1,654,230</u>	<u>-</u>	<u>-</u>	<u>1,654,230</u>	<u>75,586</u>
Total noncurrent liabilities	<u>\$ 6,503,007</u>	<u>\$ 380,000</u>	<u>\$ (112,414)</u>	<u>\$ 6,770,593</u>	<u>\$ 182,015</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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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 should 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.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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, 2004 was \$159,927. The Municipality's payroll for employees covered by ERS was approximately \$1.7 million. The Municipality total payroll for all employees was approximately \$4.7 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2004, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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, 2004 was \$19,640.
- 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. 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 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

19. COMMITMENTS

The Municipality of Vieques had several outstanding or planned construction projects as of June 30, 2004. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$10.5 million.

20. MUNICIPAL SOLID WASTE LANDFILL POSTCLOSURE

State and federal laws and regulations require the Municipality to place a final cover on the Municipality's landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with Statement No. 18 of the GASB (GASB 18), "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs," the Municipality has to performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. As of June 30, 2004, the Municipality has not performed a study of the estimated closing and postclosing costs that will be recognized in the basic financial statements as required by the GASB 18.

PART II - SINGLE AUDIT SECTION

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Federal Grantor/Program Title</u>	<u>Federal CDFA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)			
Pass-through Office of Commissioner of Municipal Affairs		00-FD-65, 01-FD-65	
State Block Grant Program (SBGP)	14.228	02-FD-65, 03-FD-65	\$1,392,009
Section 8 - Housing Choice Vouchers	14.871		306,941
Section 8 - Project Based Cluster: Lower Income Housing Assistance Program			
Section 8 - Moderate Rehabilitation	14.856		<u>315,022</u>
Total			<u>\$2,013,972</u>

See notes to schedule of expenditures of federal awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is a summary of the activity of the Municipality of Vieques' federal award programs presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements within the U.S. Housing and Urban Development Programs Fund.



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CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis O. Rivera Zúñiga

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

**INDEPENDENT AUDITOR'S 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 Vieques
Vieques, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Vieques as of and for the year ended June 30, 2004, which collectively comprise the Municipality of Vieques' basic financial statements and have issued our report thereon dated January 7, 2005. 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 Vieques' 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*. We noted certain immaterial instances of noncompliance that have reported to management of the Municipality of Vieques in a separate letter dated January 7, 2005.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Municipality of Vieques' 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.

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

San Juan, Puerto Rico
January 7, 2005

Ortiz, Rodriguez, Rivera & Co

The stamp 2000978 was affixed
to the original of this report





ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis O. Rivera Zúñiga

Members:
American Institute of Certified
Public Accountants (AICPA)
Puerto Rico Board of Certified
Public Accountants
Management Consulting
Services Division

**INDEPENDENT AUDITORS' 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 Vieques
Vieques, Puerto Rico

Compliance

We have audited the compliance of Municipality of Vieques with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. Municipality of Vieques' 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 Vieques' management. Our responsibility is to express an opinion on Municipality of Vieques'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 Vieques' 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 Vieques' compliance with those requirements.

As described in items 04-1 through 04-4 in the accompanying schedule of findings and questioned costs, the Municipality of Vieques did not comply with requirements regarding cash management, equipment and real property management, reporting and eligibility that are applicable to its States Block Grant Program, Section 8 - Housing Choice Vouchers and Section 8 - Lower Income Housing Assistance Program. Compliance with such requirements is necessary, in our opinion, for the Municipality of Vieques to comply with requirements applicable to that program.

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

Internal Control over Compliance

The management of Municipality of Vieques is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Vieques' 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.

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

San Juan, Puerto Rico
January 7, 2005

The stamp 2000979 was affixed
to the original of this report.



Ortiz, Rodriguez, Rivera & Co.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expressed a qualified opinion on the basic financial statements of the Municipality of Vieques.
- b. There were no reportable conditions on internal controls over financial reporting.
- c. No instances of noncompliance material to the financial statements of Municipality of Vieques were disclosed during the audit.
- d. There were reportable conditions on internal controls over major programs.
- e. The auditors' report on compliance with requirements applicable to federal award programs for the Municipality of Vieques expressed a qualified opinion.
- f. Audit findings relative to the major federal award programs for Municipality of Vieques are reported in number 3 of this schedule.
- g. The programs tested as major programs include:
 - 1) State Block Grant Program (SBGP) - CFDA No. 14228
 - 2) Section 8 - Housing Choice Vouchers - CFDA No. 14.871
 - 3) Section 8 - Lower Income Housing Assistance Program - CFDA No. 14.856
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Vieques was determined to be a high-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
<p>SBGP CFDA No. 14.228</p>	<p>Condition 04-1</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 24CFR 85.20(b)(7) 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>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</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
<p>SBGP CFDA No. 14.228</p>	<p>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>Condition 04-2</p> <p>The Municipality does not have effective internal controls to ensure the accurate preparation and timely submission of federal reports of the program. We noted that the Municipality does not submit to OCAM on time the annual report of projects performed with SBGP funds and project income related to them.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.20(b)(7) establishes that the federal funds recipient shall have a financial management system that will provide for the accurate, current and complete disclosures of the financial results of federally assisted activities.</p> <p><u>Cause</u></p> <p>The Municipality does not keep effective controls to ensure the timely submission of the report.</p> <p><u>Effect</u></p> <p>The continued failure to file accurately financial reports may result in actions by OCAM or the federal grantor against the Municipality, because the late submission of required reports does not allow them to adequately monitor and evaluate the Program's financial performance.</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p style="text-align: center;"><u>Recommendation</u></p> <p>The Municipality should submit on time all required reports.</p>	
<p>SBGP CFDA No. 14.228</p>	<p style="text-align: center;">Condition 04-3</p> <p>The Municipality does not have effective internal controls over compliance with the property management requirement. The Municipality took a physical inventory of program property, but the compilation report was not summarized nor compared to the property subsidiary ledger. In addition, there is no periodic review of the use and location of program equipment to ensure that these are being used for program-related purposes.</p>	<p><u>\$ -0-</u></p>
	<p style="text-align: center;"><u>Criteria</u></p> <p>The 24CFR 85.32(c)(4), (d)(3) and (4) state that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft should be investigated and adequate maintenance procedures must be developed to keep the property in good condition.</p>	
	<p style="text-align: center;"><u>Cause</u></p> <p>The above situation results from the failure to establish formal policies regarding property physical inventories, and to require reconciliation of the inventory with the property subsidiary ledger. Accordingly, this may expose the Municipality to the unauthorized use of disposition of property because there is no effective control to detect or prevent these situations.</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p><u>Effect</u></p> <p>The continued failure to establish internal controls over compliance with the above requirements expose the Municipality to unauthorized use or disposition of the programs' property and equipment.</p> <p><u>Recommendation</u></p> <p>The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.</p>	
<p>Section 8 - Housing Choice Vouchers CFDA No. 14.871</p>	<p>Condition 04-4</p> <p>The Municipality does not have effective internal controls over compliance with the property management requirement. The Municipality took a physical inventory of program property, but the compilation report was not summarized nor compared to the property subsidiary ledger. In addition, there is no periodic review of the use and location of program equipment to ensure that these are being used for program-related purposes.</p> <p><u>Criteria</u></p> <p>The 24 CFR 85.32(c)(4), (d)(3) and (4) state that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft should be investigated and adequate maintenance procedures must be developed to keep the property in good condition.</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p><u>Cause</u></p> <p>The above situation results from the failure to establish formal policies regarding property physical inventories, and to require reconciliation of the inventory with the property subsidiary ledger. Accordingly, this may expose the Municipality to the unauthorized use of disposition of property because there is no effective control to detect or prevent these situations.</p> <p><u>Effect</u></p> <p>The continued failure to establish internal controls over compliance with the above requirements expose the Municipality to unauthorized use or disposition of the programs' property and equipment.</p> <p><u>Recommendation</u></p> <p>The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.</p>	
<p>Section 8 - Housing Choice Vouchers, CFDA No. 14.871 Section 8 - Lower Income Housing Assistance CFDA No. 14.856</p>	<p>Condition 04-5</p> <p>The Municipality's system of internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 programs, we noted that the Municipality was not maintaining the required documents and information in each file to support participant's eligibility as required by Section 8 Program regulations. During our test of eligibility</p>	<p><u>\$ -0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	requirements we tested twenty-five (25) participant files and noted the following exceptions:	
	Section 8 - Housing Choice Voucher	
	<u>Social Security</u>	<u>Condition</u>
	580-11-5613	d,e,f,i
	584-62-8633	g,n
	580-16-6172	d,e,h
	580-05-5730	b,c,e,l
	584-53-6735	e,l
	401-68-3752	e
	583-65-0818	a,b,g,l
	583-23-7571	b,g
	582-02-3979	g
	581-91-5419	e,n
	582-49-7813	e,g,l
	581-59-2748	e,g,m
	Section 8 - Lower Income Housing Assistance Program	
	<u>Social Security</u>	<u>Condition</u>
	583-86-3202	b,e,g,l
	596-03-9917	e,l,n,p
	583-41-6043	e,l
	581-77-3476	e,l
	102-30-0121	e,g,l,m
	582-55-5742	e,g,l
	100-58-3992	g,l,p
	581-61-6009	g,j,l,p
	073-70-4067	e,j,l
	101-60-0497	k,l

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<ul style="list-style-type: none"> a. A participant informed that a family member was not participating in the program and that person was reported in 50058 Form. b. Recent Housing Assistance Payment document was not observed. c. In the application there's a dependent but in the 50058 Form was not informed. d. The candidate appears in the candidate list despite the fact that his program participation was finished. e. Behavior Certificate was not observed. f. The candidate did not participate in the program, the last document of Housing Assistance Payment observed has the date of 6-01-02. g. Employment or studies' evidence of a member of a family was not observed. h. The file did not present recent Housing Assistance Payment document because the candidate does not participate in the program. i. The candidate has evidence of salary, but there is no employment verification. j. Difference between third parties information and 50058. k. A lease contract with CODEFIN is due. l. Date of inspection is not recent (more than one year). m. Have intention to discontinue the participation in the program since February 13, 2004 and no action was taken until the moment of our audit on June 4, 2004. n. Have no evidence of pension or ASUME. o. There is a review in the status and income of the participant and the 50058 is not updated. p. There is no evidence of correction of deficiencies on the inspection. 	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p><u>Criteria</u></p> <p>24 CFR Sections 882-113, 882-209, 882-214, 882-412, 882-514, 882-515, 882-518, 883-711, 883-704, 889-103, 982.4, 982.54 (d) (15), 982.158 (f) (7), 982.158 (d), 982.405 (b), and 982.404 establish that the PHA is required to accept applications for admission to the projects, determine whether the applicants are initially eligible, and on a yearly basis, reexamine family income, composition, and contribution to rent, utilities reasonable rent and housing quality standards' inspections. In addition, the Municipality should verify that the information submitted by participants is reliable.</p>	
	<p><u>Cause</u></p> <p>All of the above matters occur because the Municipality's system of internal control relating to the compliance requirements is not effectively identifying and correcting these matters through the proper review of participant files for completeness of documents, signatures and information, as well as for their accuracy. The current procedures do not effectively reduce the risk of ineligible participants receiving program benefits.</p>	
	<p><u>Effect</u></p> <p>The continued failure to establish internal control over compliance with the above requirements exposes the Municipality to unauthorized user or disposition of the program's resources.</p>	
	<p><u>Recommendation</u></p> <p>The Municipality should design and adopt a checklist that includes all the related documents that must be</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p>completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF VIEQUES
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
State Block Grant Program CFDA No. 14.228	Number 03-111-01 During the grant disbursement test, one (1) disbursement voucher was found without receiving report and invoice.	The finding was corrected.
State Block Grant Program CFDA No. 14.228	Number 03-111-02 The Municipality held high cash balances according to the bank statements. This means that federal financial assistance is sometimes requested and not used to cover immediate expenditures incurred.	The finding still prevails.
State Block Grant Program CFDA No. 14.228	Number 03-111-03 The Municipality does not maintain an appropriate real property records as required by federal regulations.	The finding still prevails.
State Block Grant Program CFDA No. 14.228	Number 03-111-04 The quarterly reports were not reconciled with program books and the Municipality did not maintain evidence if there were timely submitted.	The finding was corrected.