

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE YABUCA

AUDITORIA 2001-02

30 DE JUNIO DE 2002

MUNICIPALITY OF YABUCOA
COMMONWEALTH OF PUERTO RICO
YABUCOA, PUERTO RICO

SINGLE AUDIT REPORT AND
FINANCIAL STATEMENTS
JUNE 30, 2002

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VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N MARTÍNEZ

P.O. Box 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

To the Honorable Mayor and
Members of the Municipal Assembly
Municipality of Yabucoa, Puerto Rico

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying general-purpose financial statements of the Municipality of Yabucoa, Puerto Rico, as of June 30, 2002, and for the year then ended as listed in the accompanying table of contents. These general-purpose financial statements are the responsibility of the management of the Municipality of Yabucoa, Puerto Rico. Our responsibility is to express an opinion on the general-purpose financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and 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 general-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general-purpose financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

We were unable to form an opinion on the cash balances in the aggregate amount of \$2,362,365 included in the General and Special Revenue Funds, due to deficiencies in the accounting records and internal controls.

The Municipality did not maintain a complete and accurate record of all interfund transactions in the due from and due to account balances for the year ended on June 30, 2002 nor on its beginning balance which results on a combined difference of \$600,197. As a result, we were unable to carry out the necessary audit procedures to satisfy ourselves of the adequacy of the due to and due from interfund accounts balances.

We were unable to form an opinion with respect to the amounts of property, plant and equipment presented in the accompanying general-purpose combined financial statements because of the inadequacy of the Municipality's accounting system and records that did not provide us with sufficient and competent evidence with respect to such amounts.

As more fully explained in Note 16, the Municipality has not determined the estimated landfill post closing costs that will be recognized in the general-purpose financial statements, as required by the GASB No. 18, "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs". Accordingly, no provision for liability, if any, has been made on the accompanying general-purpose financial statements.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to carry out the necessary audit procedures to reconcile the differences in the cash account balances in the General and Special Revenue Funds, examine the transactions in the due from and due to accounts balances, and examine sufficient and competent evidence over the fixed assets records and the lack of a provision, if any, for liability for landfill post closing costs, the general-purpose financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Municipality of Yabucoa, Puerto Rico, as of June 30, 2002, and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Governmental Auditing Standards, we have also issued a report dated November 22, 2002, on our consideration of the Municipality of Yabucoa, Puerto Rico, internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements of the Municipality of Yabucoa, Puerto Rico, taken as a whole. 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 not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements, and in our opinion, is fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole.

San Juan, Puerto Rico
November 22, 2002

A handwritten signature in blue ink, appearing to read "Vedra, Garcia, Lopez".

Stamp 1845296 was affixed
to the original.

MUNICIPALITY OF YABUCOA

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2002

	<u>Governmental Fund Types</u>				<u>Account Groups</u>		<u>Totals</u>
	<u>General</u>	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>General Fixed Assets</u>	<u>General Long-term Debt</u>	<u>(Memorandum only)</u>
<u>ASSETS AND OTHER DEBITS</u>							
ASSETS:							
Cash (including certificates of deposit of \$1,352,536)	\$1 176 873	\$ 743 130	\$	\$	\$	\$	\$ 1 920 003
Cash with fiscal agent	3 062	439 300	455 760				898 122
Accounts receivable:							
Other	2 831	3 828					6 659
Due from other agencies	-	10 975	69 164				80 139
Due from other funds	1 708 112	3 504 808		1 098 673			6 311 593
Property, and equipment							
Land and buildings					13 221 381		13 221 381
Furniture, machinery and equipment					4 378 500		4 378 500
Other debits:							
Amount to be provided for the retirement or payment of:							
Accrued compensated absences						1 007 637	1 007 637
General obligations bonds and notes payable						8 640 480	8 640 480
Property Taxes						833 031	833 031
Claims, judgments and other						671 669	671 669
Landfill obligations						1 200 000	1 200 000
Other long-term debt						1 535 000	1 535 000
Amount available in debt service fund						68 890	68 890
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets and other debits	\$2 890 878	\$4 702 041	\$524 924	\$1 098 673	\$17 599 881	\$13 956 707	\$40 773 104
	=====	=====	=====	=====	=====	=====	=====

(Continues)

The accompanying notes are an integral part of this combined statement.

MUNICIPALITY OF YABUCOA

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
(CONTINUED)
JUNE 30, 2002

	<u>Governmental Fund Types</u>				<u>Account Groups</u>		<u>Totals</u>
	<u>General</u>	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>General Fixed Assets</u>	<u>General Long-term Debt</u>	<u>(Memorandum only)</u>
LIABILITIES, FUND EQUITY AND OTHER CREDITS							
Liabilities:							
Accounts payable and accrued expenses	\$ 303 572	\$ 816 623	\$110 900	\$ 130 193	\$	\$	\$ 1 361 288
Due to other agencies	1 095 315						1 095 315
Due to other funds	4 038 094	646 062	134	1 027 106			5 711 396
Property Taxes						833 031	833 031
Claims, judgments and other						671 669	671 669
Other long-term debt						1 535 000	1 535 000
Accrued compensated absences						1 007 637	1 007 637
General obligation bonds and notes payable			345 000			8 709 370	9 054 370
Accrued landfill obligations						1 200 000	1 200 000
Deferred revenues							
Municipal license tax	698 330						698 330
Federal financial assistance		80 314					80 314
<u>Total liabilities</u>	<u>6 135 311</u>	<u>1 542 999</u>	<u>456 034</u>	<u>1 157 299</u>		<u>13 956 707</u>	<u>23 248 350</u>
Fund equity (deficit) and other credits:							
Investment in general fixed assets					17 599 881		17 599 881
Fund balances (deficit):							
Designated for debt service			68 890				68 890
Reserved for restricted purposes		2 858 168		(58 626)			2 799 542
Reserved for encumbrances	362 390	300 874					663 264
Unreserved	(3 606 823)						(3 606 823)
<u>Total fund equity (deficit) and other credits</u>	<u>(3 244 433)</u>	<u>3 159 042</u>	<u>68 890</u>	<u>(58 626)</u>	<u>17 599 881</u>		<u>17 524 754</u>
Total liabilities, fund equity (deficit) and other credits	\$2 890 878	\$4 702 041	\$524 924	\$1 098 673	\$17 599 881	\$13 956 707	\$40 773 104
	=====	=====	=====	=====	=====	=====	=====

The accompanying notes are an integral part of this combined statement.

MUNICIPALITY OF YABUCOA

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
ALL GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2002

	Governmental Fund Types				Totals
	General	Special Revenue	Debt Service	Capital Project	(Memorandum only)
<u>Revenues</u>					
Property taxes	\$1 902 586	\$	\$ 388 007	\$	\$ 2 290 593
Municipal license tax	1 213 398				1 213 398
Licenses, fees and permits	421 331				421 331
Intergovernmental	4 594 647	2 205 363			6 800 010
Federal financial assistance		916 641			916 641
Interest	44 040	1 125			45 165
Other	114 653	26 787			141 440
Total revenues	<u>8 290 655</u>	<u>3 149 916</u>	<u>388 007</u>		<u>11 828 578</u>
<u>Expenditures</u>					
General government	5 857 115	1 568 627		18 670	7 444 412
Public safety	632 279				632 279
Public works	737 400				737 400
Health, sanitation and welfare	648 171	456 213			1 104 384
Culture and recreation	388 845				388 845
Public instruction	135 917				135 917
Capital outlays	219 510	582 633		166 180	968 323
Debt service:					
Principal			688 508		688 508
Interest			477 354		477 354
Total expenditures	<u>8 619 237</u>	<u>2 607 473</u>	<u>1 165 862</u>	<u>184 850</u>	<u>12 577 422</u>
Excess of revenues over (under) expenditures	<u>(328 582)</u>	<u>542 443</u>	<u>(777 855)</u>	<u>(184 850)</u>	<u>(748 844)</u>

(Continues)

The accompanying notes are an integral part of this combined statement.

MUNICIPALITY OF YABUCOA

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE

ALL GOVERNMENTAL FUND TYPES

(CONTINUED)

FOR THE YEAR ENDED JUNE 30, 2002

	<u>Governmental Fund Types</u>				<u>Totals</u>
	<u>General</u>	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>(Memorandum only)</u>
<u>Other financing sources (uses)</u>					
Operating transfer - in	\$	\$	\$436 395	\$123 000	\$ 559 395
Operating transfer - out	(436 395)	(123 000)			(559 395)
Loan proceeds	600 000	505 000			1 105 000
Other	590 859				590 859
Total other financing sources (uses)	<u>754 464</u>	<u>382 000</u>	<u>436 395</u>	<u>123 000</u>	<u>1 695 859</u>
Excess of revenues over (under) expenditures and other sources	425 882	924 443	(341 460)	(61 850)	947 015
Fund balance (deficit) at beginning of year	<u>(3 670 315)</u>	<u>2 234 599</u>	<u>410 350</u>	<u>3 224</u>	<u>(1 022 142)</u>
Fund balance (deficit) at end of year	<u>(\$3 244 433)</u>	<u>\$3 159 042</u>	<u>\$ 68 890</u>	<u>\$(58 626)</u>	<u>\$ (75 127)</u>

The accompanying notes are an integral part of this combined statement.

MUNICIPALITY OF YABUCOA

COMBINED STATEMENT OF REVENUES AND EXPENDITURES -
 BUDGET AND ACTUAL
 (BUDGETARY BASIS) - GENERAL AND DEBT SERVICE FUNDS
 FOR THE YEAR ENDED JUNE 30, 2002

	General Fund			Debt Service Fund		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
<u>Revenues and other financing sources</u>						
Property taxes	\$ 367 722	\$ 367 722	\$ -	\$ 559 841	\$ 388 007	\$ (171 834)
Municipal license tax	1 307 250	1 213 398	(93 852)			
Licenses, fees and permits	500 100	421 331	(78 769)			
Intergovernmental	4 695 149	4 594 647	(100 502)			
Interest	30 000	44 040	14 040			
Other	700 335	705 512	5 177			
Other financing sources	<u>1 534 864</u>	<u>1 534 864</u>	<u>-</u>		<u>436 395</u>	<u>436 395</u>
Total revenues and other financing sources	<u>9 135 420</u>	<u>8 881 514</u>	<u>(253 906)</u>	<u>559 841</u>	<u>824 402</u>	<u>264 561</u>
<u>Expenditures</u>						
Current:						
General government	6 301 413	6 090 832	210 581			
Public safety	633 863	624 066	9 797			
Public works	771 770	743 405	28 365			
Health and sanitation	648 529	644 831	3 698			
Culture and recreation	391 806	372 248	19 558			
Public instruction	166 159	139 215	26 944			
Capital outlays	<u>221 880</u>	<u>219 510</u>	<u>2 370</u>			
Total current expenditures	<u>9 135 420</u>	<u>8 834 107</u>	<u>301 313</u>			
Debt service:						
Principal retirement and interest payment				<u>559 841</u>	<u>1 165 862</u>	<u>(606 021)</u>
Total expenditures	<u>9 135 420</u>	<u>8 834 107</u>	<u>301 313</u>	<u>559 841</u>	<u>1 165 862</u>	<u>(606 021)</u>
Excess of revenues over (under) expenditures	\$ -	\$ 47 407	\$ 47 407	\$ -	\$ (341 460)	\$ (341 460)

The accompanying notes are an integral part of this combined statement.

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

JUNE 30, 2002

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

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 personality, separate and independent from the government of the Commonwealth of Puerto Rico under Law No. 81 of August 31, 1991, known as "Ley de Municipios Autónomos". The Municipality provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, cultural and recreational as well as many other general and administrative services.

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

Accounting policies

The accounting policies of the Municipality are in accordance with the accounting principles generally accepted in the United States of America applicable to governmental entities. The following is a summary of the most significant policies:

Financial 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 Governmental Accounting Standards Board (GASB). The basic, but not the only criterion for including a potential component unit within the reporting entity is if

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MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, management has determined that there are no potential component units which should be included in the accompanying general-purpose financial statements.

Basis of presentation

The accounts of the Municipality are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. Amounts in the "totals-memorandum only" columns in the combined general-purpose financial statements represent a summation of the financial statements line items of the fund types and account groups and are presented only for analytical purposes.

The summation includes a) fund types and account groups that use different basis of accounting, b) interfund transactions that have not been eliminated and c) the caption "amounts to be provided", which is not an asset in the usual sense. Consequently, amounts shown in the "totals-memorandum only" columns are not comparable to a consolidation and do not represent the total resources available or the total revenues and expenditures of the Municipality.

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MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

The following fund types and account groups are used by the Municipality:

Governmental Funds Types

Governmental funds are used to account for the general government functions of the Municipality. The following are the Municipality's governmental fund types:

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

Special Revenue Fund - Special Revenue Fund is used to account for the proceeds of specific revenue sources (other than special assessments, or major capital projects) that are legally restricted to expenditures for specified purposes.

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

Capital Project Fund - Capital Project Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Account groups - Account groups are used to establish accounting control and accountability for the Municipality's general fixed assets and general long-term debt.

The accounting and reporting treatment applied to the fixed assets and long-term liabilities associated with a fund are determined by its measurement focus. All governmental funds are accounted for on a spending "financial flow" measurement focus. This means that only current assets and current liabilities are generally included on their balance sheets. Their reported fund balance (net current assets) is considered a measure of "available spendable resources". Governmental fund operating statements present increases (revenues and other financing sources) and decreases

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

(expenditures and other financing uses) in net current assets. Accordingly, they are said to present a summary of sources and uses of "available spendable resources" during a period.

Fixed assets used in governmental fund type operations (general fixed assets) are accounted for in the general Fixed Assets Account Group, rather than in governmental funds. Public domain ("infrastructure") general fixed assets consisting of certain improvements other than buildings, including roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems, are capitalized along with other general fixed assets. No depreciation has been provided on general fixed assets.

All fixed assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated fixed assets are valued at their estimated fair value on the date donated.

Long-term liabilities expected to be financed from governmental funds are accounted for in the General-Long Term Account Group, not in the governmental funds.

The two account groups are not "funds". They are concerned only with the measurement of financial position. They are not involved with measurement of results of operations. Since they do not affect net current assets, such long-term accounts are not recognized as governmental fund type expenditures of fund liabilities. They are instead reported as liabilities in the General Long-Term Debt Account Group.

Basis of Accounting

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

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

All governmental funds are accounted for using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recognized when they become measurable and available to pay liabilities of the current period.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of these revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the Municipality; therefore, revenues are recognized based upon the expenditures recorded. In the other, monies are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the susceptible to accrual criteria is met.

Municipal license taxes are recorded as revenues when levied, even though a portion of the taxes may be collected in the following year. Licenses and permits, sale of property and miscellaneous revenues are recorded when received in cash because they are generally not measurable until actually received.

The Municipality reports deferred revenues on its combined balance sheet. Deferred revenues arise when a potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received before the Municipality has a legal claim to them, as when grant monies are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred. Exceptions to this general rule include: (1) accumulated unpaid vacation and sick leave pay, and (2) principal and interest on general long-term debt, which are recognized when due.

Budgets and Budgetary Accounting

The following procedures are used by the Municipality in establishing the budgetary data reflected in the combined financial statements:

1. In accordance with the Law of "Municipios Autónomos" of August 31, 1991, prior to June of each year, the Mayor submits to the Municipal Assembly a proposed operating budget for the fiscal year commencing the following July 1st. The operating budget includes proposed expenditures and the means of financing them for the upcoming year, along with estimates for the current year and actual data for the last year.
2. The budget document is available for public inspection prior to its approval by the Municipal Assembly.
3. Prior to June 1st, or 10 days after being submitted to the Municipal Assembly, the budget is legally enacted through passage of an ordinance.
4. The Mayor is required by the Law of "Municipios Autónomos" to present before October 16th the results of operations of the preceding year.
5. Formal budgetary integration is employed as a management control device during the year for the General Fund.
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget. Adjustments made during the year are reflected in the budget information included in the combined financial statements.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

7. Budgetary data for the Special Revenue Fund has not been presented in the accompanying combined general-purpose financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

The budget is prepared on the budgetary basis of accounting. The actual results of operations, presented in the Statement of Revenues and Expenditures - Budget and Actual General Fund, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The principal differences between the budgetary and GAAP bases are the following:

- Encumbrances are considered as expenditures for budgetary purposes.
- Nonbudgeted funds of current year included within the general fund are not included in the budgetary basis. These funds are composed principally of budgetary surpluses of prior years.

Compensated absences

The Municipality accounts for compensated absences in accordance with the provisions of Governmental Accounting Standards Board Statement No. 16 "Accounting for Compensated Absences".

The employees of the Municipality are granted thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation time accumulated is fully vested to the employees from the first day of work. In the event of resignation, an employee is reimbursed for accumulated vacation days up to the maximum allowed. Separation of employment prior to the use of all or part of the sick leave terminates all rights for compensation except that, in the event of retirement, an employee is reimbursed for accumulated sick leave days up to the maximum allowed of 90 days, if the employee has at least 10 years of service with the Municipality.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Risk management

The Municipality is exposed to various risks of loss from torts, theft of, damage to, and destruction of assets, errors and omissions, employee injuries and illnesses, natural disasters, and other losses. Insurance coverage is obtained for claims arising from such matters. The Secretary of the Treasury of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage.

Inventories

The general fund purchases office and printing supplies, gasoline, oil and other items. The cost of inventories is recorded as an expenditure and the inventory at the year-end is not recorded in the financial statements.

Encumbrances

Encumbrance accounting is used in the government funds. Under the encumbrance system, purchase orders, contracts and other commitments for expenditures of funds are recorded to reserve that portion of the applicable appropriation for the future obligations. Encumbrances outstanding at year-end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

Accounting for pension costs

The management of the Municipality accounts for pension costs in accordance with the provisions of Governmental Accounting Standards Board Statements (GASBS) No. 27 "Accounting for Pension by States and Local Governmental Employers".

The GASBS No. 27 establishes standards of accounting and financial reporting for pension expenditures and related pension liabilities, pension assets, note disclosures, and required supplementary information in the financial reports of state and local governmental employers. The statement defines that the pension expense is equal to the statutory required contribution to the employees' retirement system.

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MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Interfund transactions

The Municipality has the following types of transactions among funds:

- Operating Transfers - Transfers legally required that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfer-out" by the disbursing fund.
- Transfers of Expenditures ("Reimbursements") - Reimbursement of expenditures made by one fund for another that are recorded as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Claims and judgments

The general long-term debt account group includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

Use of estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily related to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from those estimates.

New reporting standard

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement SB No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments". This statement establishes new financial reporting requirements for state and local governments. The statement will require, among other, the inclusion of management's discussion and analysis of the entities' financial activities along with other required supplementary information. Entities such as the Municipality with total annual revenues of \$10 million or more should apply this statement for periods beginning after June 15, 2002.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Total columns (Memorandum only)

Total columns in the general-purpose financial statements are captioned "Totals-Memorandum Only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations, in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation since interfund eliminations have not been made.

NOTE 2 CASH

Cash includes certificates of deposit amounting to \$1,352,536. The Municipality's cash balance at June 30, 2002, was entirely covered by the Federal Depository Insurance or by collateral provided by the banks and held by the Department of the Treasury of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations. Cash with fiscal agent is maintained in interest-bearing accounts in the Government Development Bank for Puerto Rico and is not collateralized.

NOTE 3 CASH WITH FISCAL AGENT

An annual special tax of 1.75% of the assessed value of all real property is levied by the Municipality. The proceeds of said tax are required to be credited to the Debt Service Fund for the payment of General Obligation Bonds and Notes of the Municipality. The property taxes are collected and retained by the Municipal Revenue Collection Center as agent for the Municipality. At June 30, 2002, cash retained by the Municipal Revenue Collection Center amounted to \$455,760.

NOTE 4 MUNICIPAL LICENSE TAX

The Municipal license tax is levied annually based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality, that are not totally or partially exempt from this tax under the Industrial Incentives Act of Puerto Rico. All taxpayers are required to file their declarations by April 23rd of each year.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 4 MUNICIPAL LICENSE TAX (CONTINUED)

The applicable tax rates are as follows:

- a. 1.50% for savings institutions and financial institutions
- b. .50% all other organizations

Taxes are payable in two equal semi-annual installments on July 1st and January 1st of the following fiscal year. The amount levied is subject to a five percent (5%) discount if payment is made before its due date, April 23rd.

Collection of taxes applicable to the next fiscal year are recorded as deferred revenues in the General Fund. The Municipality collected in advance during the current year \$698,330 corresponding to license taxes of the next fiscal year.

NOTE 5 INTERGOVERNMENTAL REVENUES

Sources of intergovernmental revenues consist primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain quasi-public corporations, such as the Puerto Rico Energy and Power Authority Grants and subsidies received from the Commonwealth of Puerto Rico which include, among others, a general subsidy for capital improvements.

All of these intergovernmental revenues are accounted for through the general fund except for those directly related to capital improvements which are accounted for through the capital project fund.

In addition to the above mentioned intergovernmental revenues, the Municipality receives federal grants which are accounted for through the special revenue fund. The federal grants are recorded under the deferred method of accounting; therefore, revenues are recognized based upon the expenditures recorded.

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 6 PROPERTY AND EQUIPMENT

Property and equipment have been acquired for general governmental purposes. Assets purchased are recorded as expenditures in the governmental funds and capitalized at cost in the General Fixed Assets Account Group or, if donated to the Municipality, at estimated fair market value at time of contribution. Depreciation is not provided on general fixed assets. Certain improvements constructed, such as roads, streets, gutters, curbs, sidewalks, and drainage, are not recorded in this group of accounts (infrastructure). These assets are immovable and of value only to the Municipality. Also, certain Municipal lots of land located in the urban zone available for sale to the citizens, are not capitalized. When a lot is sold, the Municipality adds the lot in the fixed asset group of account and at the same time, writes-off the lot.

A summary of changes in the general fixed assets for the year ended June 30, 2002, is as follows:

<u>Asset class</u>	<u>Balance July 1, 2001 (Unaudited)</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2002 (Unaudited)</u>
Land and buildings	\$13 221 381	\$ -	\$ -	\$13 221 381
Furniture, machinery and equipment	<u>3 690 080</u>	<u>688 420</u>	<u>-</u>	<u>4 378 500</u>
	<u>\$16 911 461</u>	<u>\$ 688 420</u>	<u>\$ -</u>	<u>\$17 599 881</u>
	=====	=====	=====	=====

NOTE 7 COMPENSATED ABSENCES

Employees are entitled to 30 days vacations leave and 18 days sick vacations leave per year. A maximum of 60 days of regular vacations and 90 days for sick leave, if the employee has at least 10 years of service with the Municipality, can be accumulated at the end of a calendar year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to the payment of unused sick leave upon retirement.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 7 COMPENSATED ABSENCES (CONTINUED)

In accordance with the above criteria the Municipality has accrued a liability for compensated absences earned but not taken by employees in the general long-term debt account group in the amount of \$1,007,636.

As per Law Number 156 of August 20, 1996, for fiscal years beginning on July 1, 1997, the employees have the right to accumulate the excess of 60 and 90 days in vacation and sick leaves, respectively, until December 31st of each year. That excess should be paid to the employee before March 31st of the following year.

NOTE 8 DUE TO OTHER AGENCIES

The balance of this account in the General Fund as of June 30, 2002, consists of the following:

General Services Administration	\$ 10 945
Department of Treasury	200 000
Department of Labor and Human Resources	525 729
A.A.A.	182 604
A.E.E.	31 817
P.R.T.C.	<u>144 220</u>
	\$1 095 315
	=====

NOTE 9 LONG-TERM DEBT

The following is a summary of changes in obligations of the Debt Service Fund and the General Long-Term Debt Account Group for the year ended June 30, 2002:

Total debt as of June 30, 2001	\$8 149 000
Plus: new issuances	1 105 000
Less: current retirement of principal	<u>(199 630)</u>
	9 054 370
Less: current portion	<u>(345 000)</u>
Total debt outstanding as of June 30, 2002	\$8 709 370
	=====

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 9 LONG-TERM DEBT (CONTINUED)

The following is a detail of the general bonds and special obligations as of June 30, 2002:

<u>Description</u>	<u>Balance</u>
General Obligations Bonds:	
\$610,000 Series 1986, payable in annual installments ranging from \$14,000 to \$43,000, excluding interest, through January 1, 2011; interest at 5.00%	\$ 316 000
\$400,000, Series 1986, payable in annual installments ranging from \$11,000 to \$31,000, excluding interest, through January 1, 2011; interest at 6.00%	222 000
\$225,000, Series 1989, payable in annual installments ranging from \$4,000 to \$18,000, excluding interest, through July 1, 2014; interest at 6.00%	152 000
\$657,000, Series 1991, payable in semiannual installments ranging from \$16,000 to \$47,000, excluding interest, through July 1, 2016; interest at 5.00%	484 000
\$238,000, Series 1991, payable in annual installments ranging from \$6,000 to \$17,000, excluding interest, through January 1, 2016; interest at 5.00%	<u>179 000</u>
Sub-total	<u>1 353 000</u>

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 9 GENERAL LONG-TERM DEBT (CONTINUED)

<u>Description</u>	<u>Balance</u>
Sub-total	\$1 353 000
\$510,000, Series 1992, payable in semiannual installments ranging from \$20,000 to \$60,000, excluding interest, through July 1, 2006; variable interest from 4.163% to 6.363%	210 000
\$2,080,000, Series 1995, payable in semiannual installments ranging from \$45,000 to \$195,000, excluding interest, through January 1, 2014; variable interest from 6.875% to 8.00%	1 600 000
\$106,000, Series 1995, payable in annual installments ranging from \$2,000 to \$8,000, excluding interest, through January 1, 2019; interest at 4.50%	87 000
\$36,000, Series 1995, payable in annual installments ranging from \$1,000 to \$3,000, excluding interest, through January 1, 2019; interest at 4.50%	29 000
\$120,000, Series 1997, payable in semiannual installments ranging from \$5,000 to \$15,000, excluding interest, through July 1, 2011, variable interest from 6.0% to 8.00%	90 370
\$1,500,000, Series 1998, payable in semiannual installments ranging from \$35,000 to \$140,000, excluding interest, through July 1, 2017; interest at 7.50%	<u>1 300 000</u>
Sub-total	<u>4 669 370</u>

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 9 GENERAL LONG-TERM DEBT (CONTINUED)

<u>Description</u>	<u>Balance</u>
Sub-total	\$4 669 370
\$3,310,000, Series 1998, payable in semiannual installments ranging from \$75,000 to \$305,000, excluding interest, through July 1, 2017; variable interest from 6.00% to 7.50%	2 870 000
\$600,000, Series 2002, payable in semiannual installments ranging from \$5,000 to \$50,000 excluding interest, through July 1, 2026, interest from 5% to 8%.	<u>595 000</u>
Total general obligations - bonds	8 134 370
Notes payable:	
\$270,000, Series 1998, payable in semiannual installments ranging from \$30,000 to \$45,000, excluding interest through July 1, 2005; interest at 7.00%	130 000
\$505,000, Series 2002, payable in semiannual installments ranging from \$60,000 to \$95,000 excluding interest through July 1, 2008; interest from 5% to 7%.	<u>445 000</u>
Total note payable	<u>575 000</u>
Total general obligations bonds and notes	\$8 709 370 =====

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 9 GENERAL LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize the general bonds and special obligations outstanding as of June 30, 2002 are as follows:

<u>Year ending June 30,</u>	<u>Amount</u>
2003	\$ 500 000
2004	545 000
2005	575 000
2006	566 000
2007	541 000
Thereafter	<u>5 982 370</u>
	\$8 709 370
	=====

The Municipality is subject to certain laws of the Commonwealth of Puerto Rico that limit the amount of bond debt to 10% of the assessed valuation of the real property located in the Municipality of Yabucoa, Puerto Rico.

NOTE 10 OTHER LONG-TERM DEBT

Other long-term debt consists of the following balances:

Puerto Rico Health Insurance Administration	\$ 666 070
Department of the Treasury	<u>868 390</u>
Total	\$1 535 000
	=====

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 10 OTHER LONG-TERM DEBT (CONTINUED)

The amount due to the Puerto Rico Health Insurance Administration is related with the implementation of Act No. 72 of September 7, 1993, which establishes a contribution for the medical services covered by the Health Reform based on the operational budget of the municipalities. This amount is amortized using the Municipality's lottery income.

The amount due to the Department of the Treasury consists of \$731,277 used to pay a legal settlement and \$137,653 of income tax withholdings. Both amounts are under a non-interest bearing payment plan of which monthly payment is withheld from the Municipality's monthly intergovernmental income.

NOTE 11 DEBT SERVICE FUND

Sources of debt service fund consist primarily of the "ad valorem" property taxes which are recognized as revenue when they are collected by the Municipal Revenue Collection Center. The Municipal Revenue Collection Center withholds these collections for the debt service requirements of the general obligations bonds and notes issued by the Municipality. Principal and interest on these obligations are generally paid by the Governmental Development Bank from funds transferred from the Municipal Revenue Collection Center that are obtained from the "ad valorem" taxes.

NOTE 12 PENSION PLAN

The Employee's Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality of Yabucoa, Puerto Rico under age 55 at the date of employment become members of the System as a condition to their employment.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

The System provides retirement, death and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Disability retirement benefits are available to members for occupational and non-occupational disability. 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 years and have completed at least twenty-five years of creditable service or members who have attained age of at least fifty-eight years and have completed at least ten years of creditable service, or participants with thirty years of credited services, regardless of their age, are entitled to an annual benefit, payable monthly for life.

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

Participants who have completed at least thirty years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five years of age will receive 65% of the average compensation or if they have attained fifty-five 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 years of service.

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

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amends Act No. 447, to establish, among others, a defined contribution savings plan program (the Program) to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000 and former employees who participated in the defined benefit pension plan, received a refund of their contribution and are rehired on or after January 1, 2000, become members of the Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the defined benefit pension plan, had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the defined benefit pension plan plus interest thereon to the Program.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to his/her individual account established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited semi-annually to the participant's account.

The Municipality is required by Act No. 305 to contribute 9.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for monthly benefit during the participant's life and 50% of such monthly benefit to the participant's spouse in case of the participant's death. Participants with a balance of \$10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in the participant's account will be paid in a lump sum to his/her beneficiaries. Participants have the option of a lump sum or purchasing an annuity contract in case of permanent disability.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the salary in excess of \$550 for employees hired on or before March 31, 1990. For employees hired on or after April 1, 1990, the required contribution is 8.275% of gross salary. The Municipality of Patillas, Puerto Rico contributions are 9.275% of gross salary. Total employee and employer contributions during the year ended June 30, 2002 for the Municipality of Yabucoa, Puerto Rico amounted to approximately \$300,000 and approximately \$335,000, respectively. Total payroll covered for the year was approximately \$3,600,000.

For the preceding fiscal years the Municipality of Yabucoa, contributed approximately \$215,000, which represented 100% of the required contributions.

No pension liability or asset was recorded at the beginning of the year measured in accordance with SGAS 27. Prior to the adoption of SGAS 27 at the beginning of this fiscal year no pension liability or asset was reported.

Additional information on ERS is provided in its financial statements for the year ended June 30, 2002, a copy of which can be obtained from the Retirement System Administration, PO Box 42003, San Juan, Puerto Rico 00949.

NOTE 13 PROPERTY TAXES

A. Annual Revenues

The Municipal Revenue Collection Center (CRIM) is responsible for the assessment of all the real and personal property located in the Municipality of Yabucoa, Puerto Rico and for the levy, administration and collection of the corresponding taxes.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 13 PROPERTY TAXES (CONTINUED)

The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of assessment. The annual tax rates for fiscal year ended June 30, 2002 are 8.28% for real property and 6.58% for personal property of which 1.03% of both belongs to the Commonwealth of Puerto Rico.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Department of the Treasury, instead of the property taxpayer, becomes the source of payment in these cases.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000. However, the Municipality receives the full amount levied.

The amounts advanced during the year to the Municipality by the CRIM are recorded as property taxes revenues in the General Fund. Advances in excess of actual collections received by the Municipality are recorded in the General Fund as other financial resources and as a debt in the General Long-Term Debt Account Group. The excess advances are amortized by the CRIM during the next fiscal year. The balance of the excess of property taxes collected by the Municipality amounted to \$795,957 as of June 30, 2002. No income was recognized from property taxes levied but not collected because the Municipality was not able to determine the amount of such receivable at June 30, 2002. The records for such receivables are kept and maintained by the Municipal Revenue Collection Center.

The additional special tax is recorded as revenue in the Debt Service Fund when collected, and notified to the Municipality by the Municipal Revenue Collection Center.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 13 PROPERTY TAXES (CONTINUED)

B. Prior year advances

Prior to 1994, the Department of the Treasury was the agency responsible for the assessment of real property and for the administration and collection of the related taxes. Amounts advanced by the Secretary of the Treasury to the Municipality of Yabucoa, Puerto Rico, that had not been amortized through the collections of property taxes amounted to \$37,073 as of June 30, 2002.

NOTE 14 FUND EQUITY (RESERVES AND DESIGNATIONS)

Designated for debt service - In accordance with legal restrictions, these amounts are reserved for payments of principal and interest of general long-term debt maturing in later years. The resources for this reserve arise from the additional special contribution of property taxes.

Reserved for encumbrances - The reserve for encumbrances in the amount of \$362,390 in the General fund represents the portion of purchase orders and contracts awarded for which the goods or services have not yet been received as of June 30, 2002.

Reserved for restricted purposes - These amounts are legally segregated for future capital outlays or other specific future use.

Fund deficit

Fund deficit in the General Fund of \$3,606,823 is primarily attributable to Municipality's revenues that were less than expected and to additional expenditures in general administration as a result of a legal settlement. The deficit is expected to decrease in the future as a result of a plan to reduce expenditures and obtain additional sources of revenues.

The Municipality is required by Law to provide in its current budget an amount sufficient to amortize deficits over a period of at least 30 years. During the last two years this provision has not been made.

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 15 BUDGETARY COMPARISONS

As explained in Note 1, the statement of revenues and expenditures budget and actual was prepared in accordance with the budgetary basis of accounting. This method is not in accordance in some aspects with generally accepted accounting principles.

The adjustments necessary to reconcile the revenues and expenditures for the year ended June 30, 2002 from the generally accepted accounting principles basis to the budgetary basis, are as follows:

	<u>General Fund</u>		<u>Debt Service Fund</u>	
	<u>Revenues</u>	<u>Expenditures</u>	<u>Revenues</u>	<u>Expenditures</u>
Generally accepted accounting principles basis	\$8 290 655	\$8 619 237	\$ 388 007	\$1 165 862
Plus transfer - in from transactions recorded as revenues in the budgetary basis			436 395	
Plus transfer-out from transactions recorded as expenditures in the budgetary basis		436 395		
Less change in encumbrances balance considered as expenditures on the budgetary basis		(51 087)		
Plus other financing sources considered in the budgetary basis	590 859	(170 438)		
Less prior year revenues not considered in the budgetary basis				
Budgetary basis	<u>\$8 881 514</u> =====	<u>\$8 834 107</u> =====	<u>\$ 824 402</u> =====	<u>\$1 165 862</u> =====

NOTE 16 ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS

State and federal laws and regulations requires to the Municipality to carry out certain closure work on the Municipality's landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site in the following years. In accordance with GASB Statement Number 18 "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs" the Municipality must perform a study of the closing and post closing costs in order to recognize a provision for those future estimated

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 16 ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS
(CONTINUED)

costs. Based on this study, the Municipality recognized \$1,200,000 as the Municipality's estimated current costs for landfill closure as of June 30, 2002. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. The balance of closure costs of \$1,200,000 is reported in the general long-term debt account group because it will not be funded with available expendable financial resources at June 30, 2002. The Municipality expects to finance this obligation with an assignment of the central government and federal funds.

A preliminary annual estimate of post closure costs has not been assessed as of June 30, 2002. Accordingly, no provision for future costs was recognized in the accompanying general-purpose financial statements.

NOTE 17 CONTINGENCIES

Litigations

The Municipality is a defendant in various legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigations, the Municipality has recorded liabilities of \$225,000 in the general long-term debt account group for anticipated unfavorable judgments. The amount presented in the general long-term debt group of account represents an estimate of the probable liability, which will require future available financial resources for its payment. The Municipality believes that the ultimate liability in excess of amounts provided would not be significant.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by the existing insurance. Legal counsel cannot determine the final outcome of these claims with the information currently available. As a result, the accompanying general-purpose financial statements do not include adjustments, if any, that could result from the resolution of these legal proceedings.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 17 CONTINGENCIES (CONTINUED)

Federal Financial Assistance

The Municipality receives financial assistance from the federal government in the form of grants. All grants are subject to financial and compliance audits by the grantor agencies, which could result in requests for reimbursement by the grantor agencies for expenditures, which are disallowed under the terms of the grants. The amount, if any, of expenditures which may be disallowed by the grantor agencies cannot be determined at this time. The Municipality's administration believes that such disallowances, if any, will not have a material adverse effect on the financial position of the Municipality.

Other

The Municipality has the obligation to guarantee a line of credit that the Municipal Revenue Collection Center is negotiating with the Governmental Development Bank for the payment in advance of the bond issuance made by a subsidiary of the mentioned bank for the purchase of the municipalities' uncollected property tax debt amounts for the years 1971 to 1996 made in prior years. The Municipality will guarantee the maximum amount of \$446,669 of this line of credit. The terms of the financing will be 30 years with a due date of December 1, 2032 with an interest rate of 6.50% for the first five years and a variable rate for the next twenty-five years. The source revenue for the payment of this debt will be the net increase of .48% of the intergovernmental funds collected from central government and the collections of the property tax debts.

SUPPLEMENTARY INFORMATION AND ADDITIONAL
REPORTS REQUIRED BY THE SINGLE AUDIT ACT

MUNICIPALITY OF YABUCOA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

Federal Grantor/Passed Through Grantor <u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass- Through Grantor's Number</u>	<u>Federal Expenditures</u>
U.S. Department of Housing and Urban Development Direct Programs: Section 8 - Housing Choice Vouchers	14.871	N/A	\$ 459 710
Passed Through State - Office of the Commissioner of Municipal Affairs, formerly Municipal Services Administration Programs: State Block Grant	14.228	Various	<u>164 868</u>
Total U.S. Department of Housing and Urban Development			624 578
Corporation for National and Community Service Direct Program - Ameri Corps	94.006	N/A	10 000
U.S. Department of Health and Human Services Passed through - Family and Children Administration: Childcare and Development Block Grant	93.575	N/A	198 596
U.S. Department of Justice Passed Through Puerto Rico Department of Justice: Police Corps (COPS)	16.712	N/A	<u>83 467</u>
Total Federal Financial Assistance Expenditures			\$ 916 641 =====

CFDA - Catalog of Federal Domestic Assistance
N/A - not available

MUNICIPALITY OF YABUCOA

NOTES TO SCHEDULE OF EXPENDITURES OF
FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

NOTE 1 BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Yabucoa, Puerto Rico and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic general-purpose financial statements.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying Schedule of Expenditures of Federal Awards is prepared from the Municipality's accounting records and is not intended to present its financial position or the results of its operations.
- B. The financial transactions are recorded by the Municipality in accordance with the terms and conditions of the grants, which are consistent with generally accepted accounting principles.
- C. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 3 RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Expenditures of federal awards are reported in the Municipality's Combined Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Type as follows:

<u>Description</u>	<u>Special Revenue</u>
Federal Programs expenditures	\$ 916 641
State and Municipal expenditures	<u>1 690 832</u>
Total expenditures	\$2 607 473 =====

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. Box 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

To the Honorable Mayor and
Members of the Municipal Assembly
Municipality of Yabucoa, Puerto Rico

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

We have audited the general-purpose financial statements of the Municipality of Yabucoa, Puerto Rico as of and for the year ended June 30, 2002, and have issued our report thereon dated November 22, 2002. In our report, our opinion on the general-purpose financial statements was qualified for the effects of the adjustments, if any, as might have been determined to be necessary had we been able to apply audit procedures sufficient to substantiate financial statement assertions for differences in cash accounts balances in the General and Special Revenue Funds, for the inability to examine sufficient and competent evidence for interfund transactions in the due from and due to accounts balances, the lack of adequate fixed assets records and the lack of a provision, if any, for liability of landfill post closing costs. Except as discussed in the preceding sentence, 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's general-purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general-purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider being reportable conditions. Reportable conditions involve matters coming to our consideration relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality's ability to record, process, summarize and report financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs, Part II. 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 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 believe that the reportable conditions described above are material weaknesses.

This report is intended for the information and use of the management and members of the Municipal Assembly of the Municipality of Yabucoa, Puerto Rico, federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



San Juan, Puerto Rico
November 12, 2002

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to the original.

VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

PARTNERS:

ERNESTO VALDÉS
ARTURO GARCÍA SÁNCHEZ
RAMÓN MARÍN
LUZ N. MARTÍNEZ

P.O. Box 364831
SAN JUAN, P.R. 00936-4831
TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

To the Honorable Mayor and
Members of the Municipal Assembly
Municipality of Yabucoa, Puerto Rico

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

Compliance

We have audited the compliance of the Municipality of Yabucoa, Puerto Rico (the Municipality) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2002. The Municipality's major federal programs are identified in the accompanying Schedule of Findings and Questioned Costs. Compliance with requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

In our opinion, the Municipality of Yabucoa, Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2002. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs.

Internal Control Over Compliance

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

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 does 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 for the information and use of the management and members of the Municipal Assembly of the Municipality of Yabucoa, Puerto Rico, federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
November 22, 2002



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to the original.

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2002

PART I SUMMARY OF AUDITORS' RESULTS

1. The auditors' report expresses a qualified opinion on the general-purpose financial statements of the Municipality of Yabucoa, Puerto Rico.
2. Two reportable conditions related to internal control over financial reporting were noted and reported in Part II of this Schedule.
3. No instances of non-compliance material to the financial statements of the Municipality of Yabucoa, Puerto Rico were disclosed during the audit.
4. There were no material weaknesses or reportable conditions noted on internal controls over major federal award programs.
5. The auditors' report on compliance for the major federal award programs for the Municipality of Yabucoa, Puerto Rico expresses an unqualified opinion.
6. Audit findings related to the major federal award program for the Municipality of Yabucoa, Puerto Rico are reported in Part III of this Schedule.
7. The program tested as major programs was Section 8 Housing Choice Vouchers, CFDA Number 14.871.
8. The dollar threshold for distinguishing types A and B programs was \$300,000.
9. This auditee does not qualify as a Low-Risk Auditee.

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2002

PART II FINDINGS

FINDING NUMBER 02-II-01 Reportable condition over property, plant and equipment

CONDITION During our examination of the Municipality's records and reports over property and equipment, we noted the following deficiencies:

- a. The computerized property records and reports do not reconcile with the ending balances reported in the financial statements.
- b. The Construction in Progress account is not properly recorded as part of the fixed assets.
- c. There are no adequate procedures for the valuation and recording of the real estate property.

CRITERIA Article 10-002 of the State Act Number 81 of August 30, 1991, as amended, requires the Municipality to maintain updated property records.

EFFECT Incomplete and inaccurate property records prevent adequate controls over property purchased by the Municipality.

CAUSE There are no procedures established for the reconciliation and maintenance of a property ledger as required by State regulations.

RECOMMENDATION The Municipality should implement internal control procedures in the property area in order to comply with the above requirement.

GRANTEE'S RESPONSE The Mayor gave instructions to the Finance Director and Property Manager to perform a physical inventory of the Municipality's property and prepare a reconciliation of the computerized property records and the mentioned inventory. Also, the Municipality will develop internal control procedures to value and record the real estate property and to report to the Property Manager the construction in progress and additions made to them.

(Continues)

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2002

PART II FINDINGS

FINDING NUMBER 02-II-02 Reportable condition over accounting records

CONDITION During our examination of the Municipality's records and reports, we noted the following deficiencies:

a. The general ledger of cash balances in the General and Special Revenue Funds were not reconciled with the bank reconciliation balances as of June 30, 2002. The general ledger balances were overstated by \$481,800 in the General Fund and understated by \$444,846 in the Special Revenue Fund.

b. The ending balances of interfund transactions recorded in the due from and due to accounts had a net difference of \$600,197.

CRITERIA In the Article 8.020 (c) (2) and (3) of the State Act Number 81 of August 30, 1991, as amended, it is required that the Municipality maintains accurate accounting records and fund controls.

EFFECT The records and controls over cash and interfund transactions are not adequate.

CAUSE There are no adequate procedures established for the reconciliation of cash balances and interfund transactions.

RECOMMENDATION The Municipality should implement internal control procedures in the cash and in the accounting for interfund transactions in order to maintain accurate accounting records.

GRANTEE'S RESPONSE The Finance Director will investigate the cash and interfund transactions differences found in the audit and will make the necessary adjustments to the general ledger.

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2002

PART III FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD
PROGRAMS AUDIT

Program

U.S. Department of Housing and Urban Development (HUD)

A. Section 8 Housing Choice Vouchers - CFDA No. 14.871, Grant
Period - year ended June 30, 2002

FINDING NUMBER 02-III-01 Reportable condition over utilities
payments

CONDITION During our evaluation of the Municipality's Section
8 internal control procedures we found that the
Municipality did not review the utility data rate
within the last 12 months as required by federal
regulation.

CRITERIA In the 24 CFR Section 982.5 it is required that the
Municipality must maintain an up to date utility
allowance schedule and must review the utility rate
data for each utility category each year. The
Municipality must adjust the amount of the
allowance if there has been a rate change of 10
percent or more for a utility category since the
last time revision.

EFFECT The Municipality is not in compliance with the
federal regulation.

CAUSE The Municipality is using a utility allowance
schedule that maybe not reflect the increase in
utility rates experimented in past years.

RECOMMENDATION The Municipality must implement the necessary
internal control procedures in order to comply with
this federal requirement.

QUESTIONED
COSTS None

GRANTEE'S
RESPONSE At audit date the Municipality had gathered the
data needed to evaluate the utility allowance and
is in process of analyzing it in order to up date
the utility rates.

MUNICIPALITY OF YABUCOA

STATUS OF PRIOR YEAR AUDIT FINDINGS

In the Single Audit Report for June 30, 2001, we presented to the Municipality our comments and recommendations on certain aspects that were considered deviation from compliance requirements, rules and regulations of the Section 8 Housing Choice Voucher Program.

During the current audit, we followed-up on the matters communicated in the 2001 report and noted the following:

Prior year comments

A. Community Development Block Grant

Finding Number 01-III-01 Cash Management

The Municipality disbursed federal funds between 9 to 67 days after the required minimum of five business days.

Status:

Although the Municipality instructed federal program employees about this requirement we noted that the Municipality disbursed federal fund between 11 and 38 days after the required minimum of five days business.

B. Public Assistance Grant

Finding Number 01-III-02

The Municipality did not keep adequate accounting and projects records of the FEMA funds.

Status:

The Municipality created a Municipal Office of Emergency Management and gave to the personnel of this office the responsibility of organizing the records of previous projects and to develop internal control procedures for future collection of this grant funds.