

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

MUNICIPIO DE YABUCOA
AUDITORIA 2002-2003
30 DE JUNIO DE 2003

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MUNICIPIO DE YABUCOA
Yabucoa, Puerto Rico

**Auditors' Report on General-Purpose
Combined Financial Statements with
The Additional Information and Reports
Required by the Single Audit Act**

For the year ended June 30, 2003

VALDES, GARCIA & MARIN
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

MUNICIPALITY OF YABUCOA
YABUCOA, PUERTO RICO

SINGLE AUDIT REPORTS AND
FINANCIAL STATEMENTS
JUNE 30, 2003

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VALDES, GARCIA & MARIN

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
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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, 2003, and for the year then ended, as listed in the accompanying table of contents. These general-purpose financial statements are the responsibility of the Municipality's management. 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 \$2,929,952 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, 2003 nor on its beginning balance, which results on a combined difference of \$339,678. 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 account balances.

We were unable to form an opinion with respect to the amount of property, 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 effect 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 difference in the cash account balances in the General and Special Revenue Funds, examine the transactions in the due from and due to account balances, examine sufficient and competent evidence over the property and equipment 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, 2003, 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 October 30, 2003, on our consideration of the Municipality of Yabucoa, 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 the 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.

Valdes, Gami + Maes

San Juan, Puerto Rico
October 30, 2003

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to the original.

MUNICIPALITY OF YABUCOA

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2003

	<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 \$1,301,656)	\$ 736 796	\$1 059 776	\$	\$	\$	\$	\$ 1 796 572
Cash with fiscal agent	22 464	1 110 916	1 168 407				2 301 787
Accounts receivable:							
Municipal licenses and other (net of an allowance for bad debt of \$177,471)	333 126	30 811					363 937
Due from other agencies	142 829	236 431	-				379 260
Due from other funds	2 374 159	3 822 644		1 098 673			7 295 476
Property and equipment							
Land and buildings					13 446 381		13 446 381
Furniture, machinery and equipment					4 406 773		4 406 773
Other debits:							
Amount to be provided for the retirement or payment of:							
Accrued compensated absences						733 750	733 750
General obligation bonds						9 018 650	9 018 650
Property tax advances						619 690	619 690
Claims, judgments and other						671 669	671 669
Landfill obligations						1 200 000	1 200 000
Other long-term debt						1 400 600	1 400 600
Amount available in debt service fund						890 350	890 350
Total assets and other debits	\$3 609 374	\$6 260 578	\$1 168 407	\$1 098 673	\$17 853 154	\$14 534 709	\$44 524 895
	=====	=====	=====	=====	=====	=====	=====

(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, 2003

	<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>LIABILITIES, FUND EQUITY (DEFICIT) AND OTHER CREDITS</u>							
Liabilities:							
Accounts payable and accrued expenses	\$ 402 410	\$ 624 029	\$ 121 132	\$ 115 313	\$	\$	\$ 1 262 884
Due to other agencies	790 280						790 280
Due to other funds	4 304 156	1 524 556	1 925	1 125 161			6 955 798
Property taxes						619 690	619 690
Claims, judgments and other						671 669	671 669
Other long-term debt						1 400 600	1 400 600
Accrued compensated absences						733 750	733 750
General obligation bonds			155 000			9 909 000	10 064 000
Accrued landfill obligations						1 200 000	1 200 000
Deferred revenues							
Municipal license tax	1 723 547						1 723 547
Federal financial assistance		123 170					123 170
Total liabilities	<u>7 220 393</u>	<u>2 271 755</u>	<u>278 057</u>	<u>1 240 474</u>		<u>14 534 709</u>	<u>25 545 388</u>
Fund equity (deficit) and other credits:							
Investment in general fixed assets					17 853 154		17 853 154
Fund balances (deficit):							
Designated for debt service			890 350				890 350
Reserved for restricted purposes		3 718 089		(141 801)			3 576 288
Reserved for encumbrances	196 287	270 734					467 021
Unreserved	<u>(3 807 306)</u>						<u>(3 807 306)</u>
Total fund equity (deficit) and other credits	<u>(3 611 019)</u>	<u>3 988 823</u>	<u>890 350</u>	<u>(141 801)</u>	<u>17 853 154</u>	<u>-</u>	<u>18 979 507</u>
Total liabilities, fund equity (deficit) and other credits	<u>\$3 609 374</u>	<u>\$6 260 578</u>	<u>\$1 168 407</u>	<u>\$1 098 673</u>	<u>\$17 853 154</u>	<u>\$14 534 709</u>	<u>\$44 524 895</u>
	=====	=====	=====	=====	=====	=====	=====

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

MUNICIPALITY OF YABUCOA

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
ALL GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2003

	Governmental Fund Types				Totals
	General	Special Revenue	Debt Service	Capital Project	(Memorandum (only))
<u>Revenues</u>					
Property taxes	\$2 232 655	\$	\$1 376 344	\$	\$ 3 608 999
Municipal license taxes	1 027 885				1 027 885
Licenses, fees and permits	776 622				776 622
Intergovernmental	4 736 769	1 163 732			5 900 501
Federal financial assistance		1 729 660			1 729 660
Interest	33 962	79			34 041
Other	243 167	62 959			306 126
Total revenues	<u>9 051 060</u>	<u>2 956 430</u>	<u>1 376 344</u>		<u>13 383 834</u>
<u>Expenditures</u>					
General government	5 939 349	2 515 951			8 455 300
Public safety	596 686				596 686
Public works	1 543 203				1 543 203
Health, sanitation and welfare	585 276	531 219			1 116 495
Culture and recreation	383 828				383 828
Public instruction	124 548				124 548
Capital outlays	309 363	64 479		308 175	682 017
Debt service:					
Principal			2 438 044		2 438 044
Interest			518 398		518 398
Total expenditures	<u>9 482 253</u>	<u>3 111 649</u>	<u>2 956 442</u>	<u>308 175</u>	<u>15 858 519</u>
Excess of expenditures over revenues	<u>(431 193)</u>	<u>(155 219)</u>	<u>(1 580 098)</u>	<u>(308 175)</u>	<u>(2 474 685)</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 BALANCES
 ALL GOVERNMENTAL FUND TYPES
 (CONTINUED)
 FOR THE YEAR ENDED JUNE 30, 2003

	<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	\$	\$	\$2 401 558	\$225 000	\$2 626 568
Operating transfer - out	(2 401 558)	(225 000)			(2 626 558)
Loan proceeds	2 245 000	1 210 000			3 455 000
Other	221 165				221 165
Total other financing sources	<u>64 607</u>	<u>985 000</u>	<u>2 401 558</u>	<u>225 000</u>	<u>3 676 165</u>
Excess of revenues over (under) expenditures and other sources	(366 586)	829 781	821 460	(83 175)	1 201 480
Fund balances (deficit) at beginning of year	<u>(3 244 433)</u>	<u>3 159 042</u>	<u>68 890</u>	<u>(58 626)</u>	<u>(75 127)</u>
Fund balances (deficit) at end of year	<u>(\$3 611 019)</u>	<u>\$3 988 823</u>	<u>\$ 890 350</u>	<u>(\$141 801)</u>	<u>\$1 126 353</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, 2003

	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	\$ -	\$ 570 009	\$1 376 344	\$ 806 335
Municipal license taxes	1 026 935	1 027 885	950			
Licenses, fees and permits	463 318	477 771	14 453			
Intergovernmental	4 578 134	4 736 769	158 635			
Interest	40 000	33 962	(6 038)			
Other	796 167	464 332	(331 835)			
Other financing sources	<u>1 864 933</u>	<u>1 864 933</u>	<u>-</u>		<u>2 401 558</u>	<u>2 401 558</u>
Total revenues and other financing sources	<u>9 137 209</u>	<u>8 973 374</u>	<u>(163 835)</u>	<u>570 009</u>	<u>3 777 902</u>	<u>3 207 893</u>
<u>Expenditures</u>						
Current:						
General government	5 522 623	6 496 973	(974 350)			
Public safety	614 730	599 688	15 042			
Public works	1 560 776	1 549 302	11 474			
Health, sanitation and welfare	586 947	586 834	113			
Culture and recreation	385 275	383 306	1 969			
Public instruction	127 203	120 614	6 589			
Capital outlays	<u>339 655</u>	<u>309 363</u>	<u>30 292</u>			
Total current expenditures	<u>9 137 209</u>	<u>10 046 080</u>	<u>(908 871)</u>			
Debt service:						
Principal retirement and interest payment				<u>570 009</u>	<u>2 956 442</u>	<u>(2 386 433)</u>
Total expenditures	<u>9 137 209</u>	<u>10 046 080</u>	<u>(908 871)</u>	<u>570 009</u>	<u>2 956 442</u>	<u>(2 386 433)</u>
Excess of revenues over (under) expenditures	\$ -	(\$1 072 706)	\$ (1 072 706)	\$ -	\$ 821 460	\$ 821 460
	=====	=====	=====	=====	=====	=====

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

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

JUNE 30, 2003

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 Aut6nomos". 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 fourteen 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

(Continues)

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.

(Continues)

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 or 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 the issuance 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.

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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.
- Other financing sources and uses transactions considered as revenues and expenditures for budgetary purposes.

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.

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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".

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.

(Continues)

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 relate 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 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 others, 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 less than \$10 million should apply this statement for periods beginning after June 15, 2003.

(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 \$1,301,656. The Municipality's cash balance at June 30, 2003, 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 of the Municipality. The property taxes are collected and retained by the Municipal Revenue Collection Center as agent for the Municipality. At June 30, 2003, cash retained by the Municipal Revenue Collection Center amounted to \$1,168,407.

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 \$1,723,547 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, 2003, is as follows:

<u>Asset class</u>	Balance July 1, 2002 <u>(Unaudited)</u>	<u>Additions</u>	<u>Retirements</u>	Balance June 30, 2003 <u>(Unaudited)</u>
Land and buildings	\$13 221 381	\$ 225 000	\$ -	\$13 446 381
Furniture, machinery and equipment	<u>4 378 500</u>	<u>28 273</u>	<u>-</u>	<u>4 406 773</u>
	\$17 599 881	\$ 253 273	\$ -	\$17 853 154
	=====	=====	=====	=====

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 \$733,750.

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, 2003, consists of the following:

General Services Administration	\$ 11 890
Department of Treasury	187 207
Department of Labor and Human Resources	409 810
A.A.A.	127 664
A.E.E.	31 818
P.R.T.C.	<u>21 891</u>
	\$ 790 280
	=====

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, 2003:

Total debt as of June 30, 2002	\$ 8 709 370
Plus: new issuances	3 455 000
Less: current retirement of principal	<u>(2 100 370)</u>
	10 064 000
Less: current portion	<u>(155 000)</u>
Total debt outstanding as of June 30, 2003	\$ 9 909 000
	=====

(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, 2003:

<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%	\$ 288 000
\$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%	202 000
\$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%	143 000
\$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%	459 000
\$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>170 000</u>
Sub-total	<u>1 262 000</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	\$1 262 000
\$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%	165 000
\$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%	1 515 000
\$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%	84 000
\$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%	28 000
\$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%	85 000
\$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%	<u>2 760 000</u>
Sub-total	<u>5 899 000</u>

(Continues)

MUNICIPALITY OF YABUCA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 9 GENERAL LONG-TERM DEBT (CONTINUED)

<u>Description</u>	<u>Balance</u>
Sub-total	\$5 889 000
\$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%.	585 000
\$1,910,000, Series 2002, payable in annual installments ranging from \$5,000 to \$295,000, excluding interest, through July 1, 2027; variable interest from 5% to 6.5%.	1 905 000
\$680,000, Series 2002, payable in annual installments ranging from \$10,000 to \$50,000, excluding interest, through July 1, 2027; variable interest from 5% to 6.5%.	670 000
\$230,000, Series 2002, payable in annual installments ranging from \$5,000 to \$20,000, excluding interest, through July 1, 2027; variable interest from 5% to 6.5%.	225 000
\$300,000, Series 2002, payable in annual installments ranging from \$5,000 to \$30,000, excluding interest, through July 1, 2027; variable interest from 5% to 6.5%.	295 000
\$335,000, Series 2002, payable in annual installments ranging from \$5,000 to \$25,000, excluding interest, through July 1, 2027; variable interest from 5% to 6.5%.	<u>330 000</u>
Total general obligations bonds	\$9 909 000 =====

(Continues)

MUNICIPALITY OF YABUCA

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, 2003 are as follows:

<u>Year ending June 30,</u>	<u>Amount</u>
2004	\$ 410 000
2005	440 000
2006	466 000
2007	431 000
2008	472 000
Thereafter	<u>7 690 000</u>
	\$9 909 000
	=====

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>734 530</u>
Total	\$1 400 600
	=====

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.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 10 OTHER LONG-TERM DEBT (CONTINUED)

The amount due to the Department of the Treasury consists of \$642,477 used to pay a legal settlement and \$92,053 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.

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.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

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.

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.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

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.

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 Yabucoa, Puerto Rico contributions are 9.275% of gross salary. Total employee and employer contributions during the year ended June 30, 2003 for the Municipality of Yabucoa, Puerto Rico amounted to approximately \$150,000 and approximately \$180,000, respectively. Total payroll covered for the year was approximately \$2,000,000.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 12 PENSION PLAN (CONTINUED)

For the two preceding fiscal years, the Municipality of Yabucoa contributed approximately \$215,000, and \$335,000 respectively, 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, 2003, 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.

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, 2003 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.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 13 PROPERTY TAXES (CONTINUED)

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. After final settlement performed by CRIM the advances in excess of actual collections received by the Municipality are also recorded as a debt in the General Long-Term Debt Account Group. The balance of the excess of property taxes collected by the Municipality amounted to \$587,330 as of June 30, 2003. The terms of the financing of this debt is 30 years with a due date of July 1, 2032 with a variable interest rate subject to the LIBOR rate. The source of revenue for the payment of this debt is the net increase of .48% of the intergovernmental funds collected from the central government. 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, 2003. 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.

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 \$32,360 as of June 30, 2003.

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

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 \$196,287 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, 2003.

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 \$3,611,019 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.

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.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 15 BUDGETARY COMPARISONS (CONTINUED)

The adjustments necessary to reconcile the revenues and expenditures for the year ended June 30, 2003 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	\$9 051 060	\$9 482 253	\$1 376 344	\$2 956 442
Plus transfer - in from transactions recorded as revenues in the budgetary basis	221 165		2 401 558	
Less accrual of revenues not considered in budgetary basis	(298 851)			
Plus transfer-out from transactions recorded as expenditures in the budgetary basis		502 080		
Plus change in encumbrances balance recorded as expenditures on the budgetary basis		61 747		
Budgetary basis	<u>\$8 973 374</u>	<u>\$10 046 080</u>	<u>\$3 777 902</u>	<u>\$2 956 442</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 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, 2003. 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, 2003. The Municipality expects to finance this obligation with an assignment of the central government and federal funds.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

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

A preliminary annual estimate of post closure costs has not been assessed as of June 30, 2003. 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.

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.

(Continues)

MUNICIPALITY OF YABUCOA

NOTES TO COMBINED FINANCIAL STATEMENTS

NOTE 17 CONTINGENCIES (CONTINUED)

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.

NOTE 18 SUBSEQUENT EVENTS

The Municipality obtained two loans from the Governmental Development Bank amounting to \$445,000 after June 30, 2003. The proceeds of these loans will be used for the purchase of equipment and the payment of operational debt.

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, 2003

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	\$ 542 425
Passed Through State - Office of the Commissioner of Municipal Affairs Administration Programs: Community Development Block Grant State Program	14.228	Various	<u>735 586</u>
Total U.S. Department of Housing and Urban Development			1 278 011
U.S. Department of Health and Human Services Passed through - Family and Children Administration: Childcare and Development Block Grant	93.575	N/A	375 555
U.S. Department of Justice Passed Through Puerto Rico Department of Justice: Police Corps (COPS)	16.712	N/A	<u>76 094</u>
Total Federal Financial Assistance Expenditures			\$1 729 660 =====

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, 2003

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 Types as follows:

<u>Description</u>	<u>Special Revenue</u>
Federal Programs expenditures	\$1 729 660
State and Municipal expenditures	<u>1 381 989</u>
Total expenditures	\$3 111 649 =====

VALDES, GARCIA & MARIN

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

PARTNERS:

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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, 2003, and have issued our report thereon dated October 30, 2003. 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 to be 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
October 30, 2003



Stamp 1933751 was affixed
to the original.

VALDES, GARCIA & MARIN

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

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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, 2003. 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.

MUNICIPALITY OF YABUCOA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

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 programs tested as major programs were Section 8 Housing Choice Vouchers, CFDA Number 14.871, State Block Grant, CFDA Number 14.228 and Children and Development Block Grant, CFDA Number 93.575.
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, 2003

PART II FINDINGS

FINDING NUMBER 03-II-01 Reportable condition over property, and equipment

CONDITION	During our examination of the Municipality's records and reports over property and equipment, we noted the following deficiencies: <ul style="list-style-type: none">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 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	See grantee's corrective action plan.

(Continues)

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

PART II FINDINGS

FINDING NUMBER 03-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 cash balances in the General and Special Revenue Funds were not reconciled with the bank reconciliation balances as of June 30, 2003. The general ledger balances were understated by \$122,402 in the General Fund and understated by \$102,552 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 \$339,678.

CRITERIA In Article 8.020 (C) (2) and (3) of State Act Number 81 of August 30, 1991, as amended, it is required that the Municipality maintain 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 See grantee's corrective action plan.

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

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, 2003

FINDING NUMBER 03-III-01 Reportable condition over utility 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 regulations.

CRITERIA Under 24 CFR Section 982.5 it is required that the Municipality maintain an up to date utility allowance schedule and 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 an utility allowance schedule that may not be reflecting 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 See grantee's corrective action plan.

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

FINDINGS NUMBER 03-III-02 Reportable condition over housing quality inspections

CONDITION	During our evaluation of the Municipality's Section 8 internal control procedures, we found that in two of five cases examined the Municipality failed to conduct a follow-up reinspection after the approved period granted for the correction of deficiencies on units that fail or pass with conditions the annual housing quality inspection.
CRITERIA	HUD regulations require the Municipality to inspect the units leased under the program at least annually in order to determine if the units meet the housing quality standards. Also, it is required to follow up reinspection for the units that failed to pass the annual inspection in order to verify if the deficiencies found were corrected during the prescribed period.
EFFECT	The Municipality is not in compliance with the federal regulation.
CAUSE	The deficiencies of these units does not guarantee a safe housing to families under the Section 8 Program.
RECOMMENDATION	The Municipality must implement the necessary internal control procedures in order to comply with this federal requirement.
QUESTIONED COSTS	None
GRANTEE'S RESPONSE	See grantee's corrective action plan.

MUNICIPALITY OF YABUCA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

B. Community Development Block Grant - CFDA No. 14.228,
Grant Period - year ended June 30, 2003

FINDINGS NUMBER 03-III-03 Reportable condition over cash management

CONDITION	During our audit we noted that the Municipality disbursed federal funds between 11 to 53 days after the required maximum of three business days.
CRITERIA	The Common Rule - Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, it is required to the federal funds recipient to establish a financial management system which includes procedures to minimize the time elapsed between the transfer of funds from the U.S. Treasury Department and the disbursements of funds by the Grantee.
EFFECT	The Municipality is not in compliance with the federal regulation in relation to adequate cash management.
CAUSE	The lack of proper supervision of the cash account balances caused this situation.
RECOMMENDATION	The Municipality should develop the necessary procedures for cash forecasting to minimize the time elapsed between the date of transfer of funds and the disbursement dates.
QUESTIONED COSTS	None
GRANTEE'S RESPONSE	See grantee's corrective action plan.

MUNICIPALITY OF YABUCOA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003

C. Childcare and Development Block Grant - CFDA No. 93.575,
Grant Period - year ended June 30, 2003

FINDINGS NUMBER 03-III-04 Reportable condition over procurement
procedures

CONDITION The Municipality made a purchase of equipment in excess of \$10,000 without a formal bid as required by Municipality's regulations.

CRITERIA The Municipality procurement procedures for disbursement of federal funds requires a formal bid for purchases exceeding the amount of \$10,000.

EFFECT The Municipality is not in compliance with the established procurement procedures.

CAUSE The lack of a formal bid could have precluded the Municipality from the evaluation of better alternatives for the purchase.

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

QUESTIONED COST None

GRANTEE'S RESPONSE See grantee's corrective action plan.

MUNICIPALITY OF YABUCOA

STATUS OF PRIOR YEAR AUDIT FINDINGS

In the Single Audit Report for June 30, 2002, 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 2002 report and noted the following:

Prior year comment

A. Section 8 Housing Choice Vouchers

Finding Number 02-III-01 Reportable condition over utility payments

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 regulations.

Status:

The Municipality is making a market study of the utility rates but it is still in process. The Municipality will review the existing table of utility allowances based on the results obtained in the mentioned study.