

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

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

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MUNICIPALITY OF YABUCOA, PUERTO RICO

**BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT
FOR THE YEAR ENDED JUNE 30, 2004**

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**MUNICIPALITY OF YABUCOA, PUERTO RICO
BASIC FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT
JUNE 30, 2004**

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DÍAZ CANDELARIA, P.S.C.

Certified Public Accountants and Consultants

INDEPENDENT AUDITOR'S REPORT

To Yabucoa's Honorable Mayor and
Members of the Municipality's Legislature
Yabucoa, Puerto Rico

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

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

We were unable to form an opinion on the cash balances in the aggregate amount of \$3,815,276 included in the General and Other Governmental Funds, due to deficiencies in the accounting records and internal controls.

The Municipality did not maintain a complete and accurate records of all interfund transactions (due from and due to other funds), which results on a combined difference of \$425,581. We were unable to satisfy ourselves of the balances as of June 30, 2004.

The Municipality is in the process of identifying and valuing the investment in general capital assets. However, some differences have been identified in the supporting documentation when compared to the accounting records. We were unable to satisfy ourselves about the correctness of the general capital assets balance at June 30, 2004.

INDEPENDENT AUDITOR'S REPORT
(Continuation)

As explained in Note 12b., **the Municipality** has not determined the estimated landfill post-closing costs that will be recognized in the Statement of Net Assets, as required by the GASB Statement No. 18. Accordingly, no provision for liability, if any, has been made on the accompanying governmental-wide financial statements.

As discussed in the Note 12c, **the Municipality's** legal counsel did not provide us with a complete discussion and evaluation of all pending or threatened litigation as of the date of our audit. Even when the accompanying governmental-wide financial statement include de amount of \$225,000 in connection with the estimated legal claims and judgments we were unable to propose additional adjustments, if any, that could result from the pending and threatened litigation or resolution of legal proceedings in the discovery stage.

In our opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary, in connection with the matters discussed in the preceding paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Yabucoa**, Puerto Rico, as of June 30, 2004, and the changes in financial position and the respective budgetary comparison for the general and debt service funds thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, on July 1, 2003 **the Municipality** implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34 (GASB No.34), *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, as of June 30, 2004.

INDEPENDENT AUDITOR'S REPORT
(Continuation)

The Management's Discussion and Analysis information, on pages 4 through 11, is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

January 18, 2005
San Juan, Puerto Rico

Diaz & Candelaria, PSC

License No. 34 Expires December 1, 2007
CPA Stamp # 2011515 of the State Society
of Certified Public Accountants of Puerto
Rico was affixed to the record copy of this
report.





HON. ANGEL S. GARCÍA DE JESÚS

Oficina del Alcalde

MANAGEMENT DISCUSSION AND ANALYSIS AS OF AND FOR THE FISCAL YEAR ENDED JUNE 30, 2004

The Management of the Municipality of Yabucoa (the Municipality) implemented Statement No. 34 ("Statement") of the Governmental Accounting Standards Board ("GASB"), Basic Financial Statements and Management's Discussion and Analysis for States and Local Governments, for the fiscal year ended on June 30, 2004. This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirements of such Statement, and it has been designed accordingly with the following goals:

- Assist the reader in focusing on significant financial issues.
- Provide an overview of the Municipality's financial activity.
- Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges).
- Identify any material deviations from the financial plan (the approved budget).
- Identify individual fund issues or concerns.

Because fiscal year 2003-2004 represents the first year in which the Municipality implemented the provisions of the Governmental Accounting Standards (GASB) Statement No. 34, this discussion and analysis provides few comparisons with the previous year. In future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

FINANCIAL HIGHLIGHTS

- The Municipality's assets exceeded its liabilities by \$2.9 millions (net assets).
- The net assets increased by \$2 millions.
- In the fund financial statements, the governmental activities revenue increased \$4.6 millions (or 35%) and governmental activities' expenditures increased \$2 millions (or 14%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, an increase on fund balance of \$523,473.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$870,001.
- The Municipality issued bonds amounting to \$750,000 to finance capital improvements, for the purchase of equipment and to pay a debt with the Treasury Department.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Management's Discussion and Analysis introduces the Municipality's financial statements. The basic financial statements include: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements.

This new financial statements change the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

Government -Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies. These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality as a whole is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

A fund is an accountability unit used to maintain control over resources segregated for specific activities or objectives. Within the basic financial statements, fund financial statements provide detailed information about the Municipality's most significant funds, not the Municipality's as a whole. Major funds are separately reported while all others are combined into a single, aggregated presentation. The Municipality's funds are all included in Governmental Funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both of the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Infrastructure Assets

Historically, a government's largest group of assets (infrastructure - roads, bridges, etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

Historically, the infrastructure assets have not been reported nor depreciated in governmental financial statements. As of July 1, 2003, the Municipality commenced the reporting of infrastructure assets. Also, the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's net assets (excess of assets over liabilities) totaled \$2,913,554 at the end of fiscal year 2003-2004, compared to \$723,951 at the end of the previous fiscal year. The largest portion of the Municipality's net assets is the investment in capital assets, net of related debt.

Condensed Statement of Net Assets June 30, 2004

Current and non-current assets	\$ 7,877,641
Capital assets	<u>15,388,663</u>
Total assets	<u>23,266,304</u>
Current liabilities	6,742,623
Noncurrent liabilities	<u>13,610,127</u>
Total liabilities	<u>20,352,750</u>
Net Assets:	
Investment in capital assets	6,264,663
Restricted	4,354,541
Unrestricted	<u>(7,705,650)</u>
Total net assets	<u>\$ 2,913,554</u>

Changes in Net Assets

The Municipality's net assets increase by \$2,189,602. Approximately 28 percent of the Municipality's total revenue came from taxes, while 63 percent resulted from grants and contributions, including federal assistance. Charges for Services provided 3 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, public ways and facilities, and health, sanitation and welfare.

Condensed Statement of Activities June 30, 2004

Program revenues	
Charges for services	\$ 508,444
Operating grants and contributions	1,648,543
Capital grants and contributions	-
General revenues:	
Property taxes	3,044,250
Municipal license tax	2,048,757
Grants and contributions not restricted to specific programs	9,840,827
Interest and investment earning	58,087
Miscellaneous	<u>918,088</u>
Total revenues	18,066,996
Expenses:	
General government	7,284,351
Public safety	959,086
Public ways and facilities	3,948,336
Health, sanitation and welfare	1,818,787
Culture and recreation	953,592
Public instruction	333,708
Interest on long-term debt	<u>579,534</u>
Total expenses	<u>15,877,394</u>
Change in net assets	2,189,602
Net assets, beginning of year	<u>723,952</u>
Net assets, end of year	<u>\$ 2,913,554</u>

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

The Focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending funds balances of \$1.9 millions, an increase of \$819,242 in comparison with the prior year. There are reservations of fund balance amounting to \$5.5 millions. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$1,217,426), 2) to pay debt service (\$1,742,215) or 3) to pay for capital projects. Accordingly, \$3,626,371 constitutes a deficit in the fund balance.

Within the governmental funds, it is included the general fund which is the primary operating fund of the Municipality. As of June 30, 2004, the general fund has a deficit of \$3 millions on fund balance.

GENERAL FUND BUDGETARY HIGHLIGHTS

The General Fund budget for fiscal year 2003-2004 was 10.9 million, \$1.8 million over the previous year amended budget.

Over the course of the year, the Municipality Council revised the Municipality's budget in the amount of \$975,686, in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2004, amounts to \$21 millions, net of accumulated depreciation of \$5.6 millions, leaving a net book value of \$15.4 millions. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks and similar items.

The total increase in the Municipality's investment in capital assets for the current fiscal year was about 8.8% in terms of net book value. Actual expenditures to purchase or construct capital assets were \$2.1 million approximately for the year. Depreciation charges for the year totaled \$860,829.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purpose and cannot be used for any other purposes. As of June 30, 2004 the Municipality's unexpended proceeds from bond issuances that are committed to future construction activities is not available.

Summary of Capital Assets Net of Accumulated Depreciation June 30, 2004

Non-depreciable assets	\$ 1,662,727
Depreciable assets	<u>13,725,936</u>
Total	<u>\$ 15,388,663</u>

Debt Administration

At the end of the fiscal year, the Municipality have general long-term debt obligation outstanding of \$14.4 million.

Summary of Long-Term Debt June 30, 2004

Accrued compensated absences	\$ 716,497
Bonds payable	10,209,000
Liability for claims and judgments	225,000
Property tax advances	600,038
Landfill obligation	1,200,000
Health reform liability	464,350
Other long-term liabilities	<u>1,005,819</u>
Total	<u>\$ 14,420,704</u>

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged. The applicable law also requires that in order for a municipality to be able to issue additional general obligation bonds and notes such municipality must have sufficient "payment capacity."

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on state contributions and federal grants as well as licenses and permits, municipal tax and property taxes to carry out the government activities.

For the fiscal year 2004-2005, the Municipal Legislature approved a General Fund budget of \$12.5 millions, \$0.5 millions more than the previous amended budget.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at (787) 893-3000.

**MUNICIPALITY OF YABUCOA
STATEMENT OF NET ASSETS
JUNE 30, 2004**

	<u>Governmental Activities</u>
<u>ASSETS</u>	
Cash in banks; including certificates of deposits	\$ 2,658,783
Cash with fiscal agent	2,246,110
Account receivable:	
Municipal license tax and other	197,416
Due from other agencies	523,015
Federal government / pass-through grantor	1,802,716
Other	449,601
Capital assets, net of accumulated depreciation	<u>15,388,663</u>
Total assets	\$ <u><u>23,266,304</u></u>
 <u>LIABILITIES</u>	
Accounts payable and accrued liabilities	\$ 1,323,606
Due to other agencies	602,517
Deferred revenues	3,662,055
Matured bonds and interest payable	343,868
General long-term debts:	
Due within one year	810,577
Due in more than one year	<u>13,610,127</u>
Total Liabilities	<u><u>20,352,750</u></u>
 <u>NET ASSETS</u>	
Invested in capital assets, net of related debt	6,264,663
Restricted for:	
Debt service	1,742,216
Capital projects	(400,062)
Other purposes	3,012,387
Unrestricted	<u>(7,705,650)</u>
Total net assets	<u><u>2,913,554</u></u>
Total liabilities and net assets	\$ <u><u>23,266,304</u></u>

The accompanying notes are an integral part of these financial statements

**MUNICIPALITY OF YABUCOA
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2004**

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets
		Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
					Governmental Activities
General government	7,284,351	508,444	-	-	(6,775,907)
Public safety	959,086	-	-	-	(959,086)
Public ways and facilities	3,948,336	-	1,000,000	-	(2,948,336)
Health, sanitation and welfare	1,818,787	-	648,543	-	(1,170,244)
Culture and recreation	953,592	-	-	-	(953,592)
Public instruction	333,708	-	-	-	(333,708)
Interest on long term debt	579,534	-	-	-	(579,534)
Total governmental activities	\$ 15,877,394	\$ 508,444	\$ 1,648,543	\$ -	(13,720,407)
General Revenues:					
					3,044,250
Property taxes					2,048,757
Municipal license taxes					9,840,827
Grants and contributions not restricted for specific programs					58,087
Interests					918,088
Miscellaneous					
Total general revenues					<u>15,910,009</u>
Change in net assets					2,189,602
Net assets at beginning of year					<u>723,952</u>
Net assets at end of year					<u>\$ 2,913,554</u>

The accompanying notes are an integral part of these financial statements

MUNICIPALITY OF YABUCOA
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2004

	General	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash and certificates of deposit	\$ 1,709,124		\$ 33,696	\$ 915,963	\$ 2,658,783
Cash with fiscal agent	22,464	\$ 1,089,617	-	1,134,029	2,246,110
Account receivable:					
Municipal licenses tax and other	197,416	-	-	-	197,416
Due from other agencies	523,015	-	-	-	523,015
Federal agency / Pass - through grantor		1,000,000	100,000	702,716	1,802,716
Due from other funds	3,241,875	4,547	1,098,674	4,144,407	8,489,503
Other	-	-	-	24,020	24,020
Total assets	\$ 5,693,894	\$ 2,094,164	\$ 1,232,370	\$ 6,921,135	\$ 15,941,563
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable and accrued liabilities	\$ 687,130	\$ 8,081	\$ 97,393	\$ 531,002	\$ 1,323,606
Due to other agencies	602,517	-	-	-	602,517
Due to other funds	4,493,776	-	1,392,715	2,177,431	8,063,922
Matured bonds and interest payable	-	343,868	-	-	343,868
Deferred revenue:					
Municipal licenses tax	2,998,017	-	-	-	2,998,017
Federal grant revenues	-	-	142,324	521,714	664,038
Total liabilities	8,781,440	351,949	1,632,432	3,230,147	13,995,968
Fund balances:					
Reserved for:					
Encumbrances	538,825	-	-	678,601	1,217,426
Debt services	-	1,742,215	-	-	1,742,215
Capital projects	-	-	(400,062)	-	(400,062)
Restricted purpose	-	-	-	3,012,387	3,012,387
(Deficit) fund balance:					
General fund	(3,626,371)	-	-	-	(3,626,371)
Total fund balance	(3,087,546)	1,742,215	(400,062)	3,690,988	1,945,595
Total liabilities and fund balance	\$ 5,693,894	\$ 2,094,164	\$ 1,232,370	\$ 6,921,135	\$ 15,941,563

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

MUNICIPALITY OF YABUCOA, PUERTO RICO

**Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
June 30, 2004**

Total fund balances for governmental funds		\$ 1,945,595
Total net assets reported in the statement of governmental activities is different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the Governmental Funds Statement. Those assets consist of:		
Land	\$ 230,000	
Construction in progress	1,432,727	
Buildings and improvements, infrastructure, equipment and vehicles, net of \$5,692,564 accumulated depreciation	<u>13,725,936</u>	
Total capital assets		15,388,663
Long-term liabilities applicable to the Municipality's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities. All liabilities-both current and long-term-are reported in the Net Assets. Balances at June 30, 2004, were:		
Compensated absences		(716,497)
Bonds and notes payable		(10,209,000)
Liability for claims and judgments		(225,000)
Property tax advances		(600,038)
Landfill closure costs		(1,200,000)
Health reform liability		(464,350)
Other long-term liabilities		<u>(1,005,819)</u>
		<u>(14,420,704)</u>
Total net assets of governmental activities		\$ <u>2,913,554</u>

MUNICIPALITY OF YABUCOA
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
GOVERNMENTAL FUND
JUNE 30, 2004

	General	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
REVENUES:					
Property taxes	\$ 2,527,723	\$ 516,527			\$ 3,044,250
Municipal licenses tax	2,048,757	-			2,048,757
Licenses, permits and other local taxes	490,384	-			490,384
Charges for services	18,060	-			18,060
Interest	57,965	-	\$ 8	\$ 114	58,087
Intergovernmental:					-
Federal	-	-	-	1,712,369	1,712,369
Local	5,831,661	1,000,000	857,676	2,087,664	9,777,001
Other	918,088	-	-	-	918,088
Total revenues	11,892,638	1,516,527	857,684	3,800,147	18,066,996
EXPENDITURES:					
General government	3,934,909	-	-	3,534,142	7,469,051
Public safety	844,975	-	-	-	844,975
Public ways and facilities	3,751,394	-	-	-	3,751,394
Health, sanitation and welfare	1,086,088	-	-	716,296	1,802,384
Culture and recreation	740,497	-	-	-	740,497
Public instruction	322,236	-	-	-	322,236
Capital outlays	-	-	1,115,945	524,987	1,640,932
Health reform debt amortization	-	201,720	-	-	201,720
Property tax advances amortization	-	19,650	-	-	19,650
Other long-term debt amortization	-	175,381	-	-	175,381
Debt service:					
Principal	-	450,000	-	-	450,000
Interest	-	579,534	-	-	579,534
Total expenditures	10,680,099	1,426,285	1,115,945	4,775,425	17,997,754
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	1,212,539	90,242	(258,261)	(975,278)	69,242
OTHER FINANCING SOURCES (USES):					
Operating transfer from other funds	187,207	761,623	-	114,650	1,063,480
Proceeds from issuance of long-term debts	-	-	-	750,000	750,000
Operating transfer to other funds	(876,273)	-	-	(187,207)	(1,063,480)
Total other financing sources (uses)	(689,066)	761,623	-	677,443	750,000
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES AND OTHER FINANCING SOURCES (USES)	523,473	851,865	(258,261)	(297,835)	819,242
FUND BALANCES (DEFICIT), AT BEGINNING OF YEAR	(3,611,019)	890,350	(141,801)	3,988,823	1,126,353
FUND BALANCES (DEFICIT), AT END OF YEAR	\$ (3,087,546)	1,742,215	(400,062)	\$ 3,690,988	\$ 1,945,595

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

MUNICIPALITY OF YABUCOA, PUERTO RICO

**Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances of Governmental Funds to
the Statement of Activities
For the year ended June 30, 2004**

Net change in fund balances-Governmental Funds Statement \$819,242

Governmental Funds Statement reports capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation expense in the current period. 1,256,356

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable available financial resources. In the Statement of Activities, however, which is presented on the accrual basis, expenses and liabilities are reported regardless of when financial resources are available. In addition, interest on long-term debt is not recognized under modified accrual basis of accounting until due.

These adjustments combine the net changes of the following balances:

Compensated absences	17,253
Property tax advances	19,650
Health reform liability	201,720
Other long-term liabilities	175,381

Bond proceeds provide current financial resources to governmental funds, but, issuing debt increases long-term liabilities in the Statement of Net Assets. (750,000)

Repayment of bond principal is an expenditure in the governmental funds, but it reduces the long-term liabilities in the Statement of Net Assets.

Change in Net Assets of Governmental Activities 450,000
\$ 2,189,602

MUNICIPALITY OF YABUCOA

STATEMENT OF REVENUES AND EXPENDITURES - GENERAL AND DEBT SERVICE FUNDS
 BUDGET AND ACTUAL
 BUDGETARY BASIS - GENERAL FUND
 YEAR ENDED JUNE 30, 2004

	General Fund				Debt Service Fund			
	Budgeted Amounts		Adjusted Actual Note 1	Variance with Final Budget Favorable (Unfavorable)	Budgeted Amounts		Adjusted Actual Note 1	Variance with Final Budget Favorable (Unfavorable)
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 2,099,135	\$ 2,099,135	\$ 2,527,723	\$ 428,588	\$ 661,648	\$ 661,648	\$ 516,527	\$ (145,121)
Municipal licenses tax	1,850,000	2,196,000	2,048,757	(147,243)	-	-	-	-
Licenses, permits and other local taxes	461,000	710,000	490,384	(219,616)	-	-	-	-
Interest	25,000	57,907	57,965	58	-	-	-	-
Intergovernmental	5,283,197	6,028,862	5,831,661	(197,201)	-	-	-	-
Other	482,000	940,315	936,148	(4,167)	-	-	-	-
Total revenues	10,200,332	12,032,219	11,892,638	(139,581)	661,648	661,648	516,527	(145,121)
EXPENDITURES								
Current:								
General government	5,968,874	5,482,657	4,277,447	1,205,210	-	-	-	-
Public safety	766,459	885,597	844,975	40,622	-	-	-	-
Public ways and facilities	2,182,690	3,517,907	3,751,394	(233,487)	-	-	-	-
Health, sanitation and welfare	619,244	1,095,795	1,086,088	9,707	-	-	-	-
Culture and recreation	431,149	714,101	740,497	(26,396)	-	-	-	-
Public instruction	231,916	336,162	322,236	13,926	-	-	-	-
Debt service:								
Principal and interest	-	-	-	-	661,648	661,648	659,816	1,832
Total expenditures	10,200,332	12,032,219	11,022,637	1,009,582	661,648	661,648	659,816	1,832
Excess of revenues over expenditures	\$ -	\$ -	\$ 870,001	\$ (1,149,163)	\$ -	\$ -	\$ (143,289)	\$ (146,953)

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

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2004

GENERAL ORGANIZATION

The **Municipality of Yabucoa (the Municipality)** was founded in 1793. 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 governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of Puerto Rico. The legislative body consists of fourteen (14) assemblymen also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public safety, sanitation, recreation and sports, education, housing, transportation, welfare, construction and/or improvements of highways and streets, and other general and administrative services.

The financial statements of **the Municipality** have been prepared in accordance with Generally Accepted Accounting Principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which along with subsequent GASB Pronouncement (Statements and Interpretations,) constitute GAAP for governmental units. A summary of **the Municipality's** significant accounting policies consistently applied in the preparation of the accompanying basic financial statements follows:

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Reporting Entity

The Municipality's financial statements include the operations of all departments and separate legal entities for which **the Municipality** is financially accountable or for which exclusion would leave the financial statements misleading or incomplete.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continuation)

a. **Reporting Entity** (Continuation)

In June 1999, the GASB issued Statement No. 34 *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*. This Statement establishes new financial reporting requirements for state and local governments. It requires new information and restructures much of the information that governments have reported in the past. Comparability with reports issued in prior years is affected. In June 2001, the GASB issued Statement No. 37 *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments Omnibus*, which in part addressed the Management Discussion and Analysis (MD&A) requirements, Program Revenue Classifications and Major Fund criteria requirements in the reporting model in Statement No. 34.

The **Municipality of Yabucoa** is required to implement this Standard for the fiscal year ended June 30, 2004.

b. **Financial Reporting Entity**

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor, and (2) whose funds are under the legal custody and control of **the Municipality's** Finance Director, as prescribed by Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico*. **The Municipality's** management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with **the Municipality** may be such that exclusion of their financial statements from those of **the Municipality** would cause **the Municipality's** basic financial statements to be misleading or incomplete according to GASB Statement No. 14, - *The Financial Reporting Entity* (GASB No.14.)

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of **the Municipality** as of June 30, 2004 nor for the year then ended.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continuation)

c. **Basic Financial Statements-GASB Statement No. 34**

The basic financial statements include both government-wide and fund financial statements. While the previous model emphasized fund types (the total of all funds of a particular type), in the new reporting model the focus is on major individual funds (within the fund financial statements). Both the government-wide and fund financial statements categorize activities as governmental activities. In the government-wide Statement of Net Assets the governmental activities (a) are presented on a consolidated basis in one column, and (b) are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The government-wide Statement of Activities reflects both the gross and net cost per functional category. The Statement of Activities reduces gross expenses (including depreciation) by related operating grants and contributions. The operating grants include operating-specific grants.

This government-wide focus is more on the substantiality of **the Municipality** the change in aggregate economic position resulting from the activities of the fiscal period.

The fund financial statements are, in substance, very similar to the financial statements presented in the previous model. Emphasis here is on the major funds in the governmental category. Non-major funds are aggregated into a single column.

The governmental funds financial statements are presented on a current financial resource measurement focus and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. This presentation is deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how **the Municipality** actual experience conforms to the budget or fiscal plan. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, a reconciliation is presented on the fund statements, which briefly explains the adjustments necessary to transform the fund statements into the governmental wide statements.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continuation)

d. **Basis of Presentation**

The new model as defined in Statement No. 34 establishes criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of either fund category or the governmental and enterprise combined) for the determination of major funds. **The Municipality** reports the following major funds on **Fund Financial Statements**:

Governmental Funds

General Fund – Always a major fund. The general fund is the main operating fund of **the Municipality**. It is used to account for all financial resources except those required to be accounted for in other funds.

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

Capital Projects Fund - Capital projects fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements which are not financed by other funds.

e. **Basis of Accounting**

The accounts of **the Municipality** are organized on the basis of funds, each of which is considered to be a separate accounting entity. **The Municipality** has created various types of funds. Each fund is accounted for by a separate set of self-balancing accounts, which include its assets, liabilities, fund balances, and revenues and expenditures/ expenses, as applicable. The individual funds accounts for the governmental resources allocated to **the Municipality** for the purpose of carrying on specific activities in accordance with laws, regulations, or other restrictions.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

e. Basis of Accounting (Continuation)

Measurement Focus & Basis of Accounting

Government-wide Financial Statements. The government wide financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non exchange transactions, in which **the Municipality** gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants. Revenue from grants is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Funds Financial Statement. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Available means collectible within the current period or 60 days after the end of the period to use them to pay liabilities of the current period. Miscellaneous revenues are recorded when collected. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the year to which they apply. Expenditures are generally recognized when the related fund liability is incurred. General capital asset acquisitions are reported as expenditures in governmental funds.

Governmental Fund Types/Governmental Activities. Governmental funds are those through which most governmental functions of **the Municipality** are financed. The acquisition, use, and balances of **the Municipality's** expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. Licenses and permits, charges for services, fines and forfeits and miscellaneous revenues (except investment earnings) are recorded as revenues when received. Investment earnings (interest) are recorded as earned since they are measurable and available.

MUNICIPALITY OF YABUCOA, PUERTO RICO

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

f. Encumbrances

Governmental funds employ encumbrances accounting. Under the encumbrance system, all purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation. Under generally accepted accounting principles, encumbrances outstanding at year-end are reported as reservations of fund balance and they constitute neither expenditures, nor liabilities. Encumbrances constitute the equivalent of expenditures for budgetary purposes only, and, accordingly, are reported with expenditures in all budgetary basis statements.

g. Budgetary Data

The Municipality follows these procedures, which are in accordance with the municipal law; in establishing the budgetary data reflected in the basic financial statements.

- (1) On or prior to May 15, the Mayor submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.
- (2) The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- (3) Prior to July 1st, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- (4) 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 amounted to \$1,831,887 are reflected in the budget information included in the basic financial statements.

The budget is prepared following the modified accrual basis of accounting except for the encumbrances as described below.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

g. Budgetary Data (Continuation)

The actual results of operations, presented in the Statement of Revenues, Expenditures and Changes in Fund Balances-Budget and Actual-General Fund, are reflected in conformity with the budgetary accounting of **the Municipality** for a better comparison with the budget information.

Amendments to the budget, and budgetary transfers related to personal expenditures, require the approval of the Municipal Assembly. Non-capital encumbrances lapse at the end of the next fiscal year. During the fiscal year, **the Municipality** readjusted its original budget of the General Fund Balance by \$1,831,887 from current year resources increase.

Since the budgetary basis differs from generally accepted accounting principles (GAAP), actual amounts for the general fund and debt service fund in the accompanying Statement of Revenues and Expenditures-Budget and Actual are presented on the budgetary basis to enhance comparability. The principal differences are as follows:

- (1) Encumbrances are recorded as expenditures under the budgetary basis and as reservations of fund balance under the GAAP basis.
- (2) The property tax advances are presented as revenue in the budgetary basis and as other financing sources in the GAAP basis.
- (3) **The Municipality** receives certain revenues as contributions from governmental entities, legislative and private parties, which are not included therein nor are the related expenditures.

The necessary adjustments to convert the result of operations of the general and debt service funds from the modified accrual basis of accounting to the budgetary basis are as follows:

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

g. Budgetary Data (Continuation)

	General Fund	Debt Service Fund
Excess of revenues and other financing sources over expenditures and other financing uses (Budgetary-Statutory Basis)	\$ 870,001	(\$ 143,289)
Non-budgeted revenues	-	1,000,000
Operating transfer from other funds	187,207	761,623
Operating transfer to other funds	(876,273)	-
Non-budgeted expenditures	-	(766,469)
Current year encumbrances recognized as expenditures on the budgetary basis	<u>342,538</u>	<u>-</u>
 Excess of revenues (expenditures) and other financing sources (uses) over expenditures (revenues) and other financing sources (uses) (GAAP basis)	 <u>\$ 523,473</u>	 <u>\$ 851,865</u>

The Municipality has not legally adopted a budget for the special and capital projects funds. Accordingly, it has not presented an annual comparison of budget and actual for these major funds.

h. Cash and Cash Equivalent

Substantially all cash balances are commingled in a general checking account and several special purpose bank accounts, except for cash and investments restricted by law. Each fund records its equity interest in the pooled cash balance. The available cash balance in the general checking account beyond immediate needs is invested in interest-bearing deposits. Generally, cash is deposited in interest-bearing bank accounts. Investment earnings are credited to the respective fund.

Investments consist of short-term certificates of deposit and are stated at cost, which approximates fair value.

MUNICIPALITY OF YABUCOA, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

i. Inventories

The general fund purchases office and printing supplies, gasoline, oil, medicines and other items. The cost of purchases is recorded as expenditure and the inventory is not recorded in the basic financial statements since amount is insignificant.

j. Capital Assets

Fund Financial Statements

The Municipality charged costs of capital outlays as expenditures categories in the Governmental Fund Financial Statements.

Government Wide Financial Statements

Capital assets purchased are carried at historical costs. Contributed assets are recorded at their estimated fair value at the time they are received by **the Municipality** and are capitalized in the Statement of Net Assets. Major renewals and betterment are capitalized: replacement, maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to operations.

Depreciation on capital assets is calculated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful Lives</u>	<u>Capitalization Threshold</u>
Vehicles and Heavy Equipment	5 - 20 years	\$100
Furniture and Fixture	5 - 10 years	\$100
Computer and Electronic Equipment	5 - 15 years	\$100
Buildings	40 - 60 years	\$100
Infrastructure	40 - 60 years	\$100
Improvements	20 - 40 years	\$100

In addition, the Municipality assigned a 10% residual value to all depreciable capital assets.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continuation)

k. **Interfund Transactions**

The **Municipality** has the following types of transaction 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.
- * ***Transfer of Expenditures (“Reimbursements”)*** – Reimbursement of expenditures made by one fund on behalf of other that are recorded as expenditures in the reimbursing fund and as a reduction or expenditures in the reimbursed fund.

l. **Vacation and Sick Leave and Other Compensated Absences**

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed.

Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years or more of service who are entitled to sick leave pay to the maximum allowed. **The Municipality** is required to pay excess sick leave over 90 days on or before March 31 of the accumulated excess at December 31 of prior year.

Employees' maximum allowed accumulated vacation is accounted in the Statement of Net Asset.

m. **Insurance**

The Municipality carries commercial insurance to cover casualty, theft, tort claims and coverage for its public facilities and equipment, primarily to provide protection in case of disaster and other losses. Also, principal officials of **the Municipality** are covered under various surety bonds.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

m. Insurance (continuation)

The Treasury Department of the Commonwealth of Puerto Rico is the designated agency to obtain the necessary insurance coverage and policies which cost are allocated among all municipalities of Puerto Rico. Cost of insurance allocated to **the Municipality** and deducted from the gross property taxes collections by the CRIM for the year ended June 30, 2004 amounted to approximately \$198,756. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$208,500 for workers compensation insurance covering all municipal employees.

n. Restricted Assets

Cash with fiscal agent

The cash with fiscal agent pertaining to the debt service represents property tax collections retained by the Government Development Bank for Puerto Rico and another financial institution restricted for the payment of **Municipality's** debt service (See Note 2).

o. Long-term obligations

The liabilities reported in the governmental-wide financial statements include the general and special obligation bonds, long-term notes, other long-term liabilities, such as vacation and sick leave, claims and judgments, long-term liabilities to other governmental entities and landfill closure care cost.

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

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continuation)

p. **Claims and Judgments**

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund and in the Statement of Net Assets.

q. **Reservations of Fund Balance**

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

- * ***Encumbrances*** - Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
- * ***Debt Service*** - Represents net assets available to finance future debt service payments.
- * ***Capital Projects*** - Represent net assets available to finance future capital outlays.
- * ***Restricted Purpose*** - Represent mainly resources set aside for use in federal and state grant programs accounted for in the other governmental funds.

r. **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affects the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

s. Totals Column (Memorandum Only) Governmental Funds Statement

The total data under this column is 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.

2. PROPERTY TAXES

The "Centro de Recaudación de Ingresos Municipales" (CRIM) is responsible for the assessment of all real and personal property located within the **Municipality of Yabucoa** 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 the assessment.

Real property taxes are billed by the CRIM and are due in two equal installments in July and January following the assessment date. Personal property taxes are self-assessed and are due in May 15, when the property tax return is required to be filed.

The tax rate per annum is 8.58% for real property and 6.58% for personal property. The "ad-valorem" tax withheld by the CRIM represents 1.75% as fiscal agent, and restricted for debt service which is accounted for through the debt service fund (See Note 8). **The Municipality** has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the "ad-valorem" tax rate.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

2. PROPERTY TAXES (Continuation)

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. Veterans have additional exemption from taxes of \$5,000 of the assessed value of real property.

The Department of Treasury instead of the property taxpayer becomes the source of payment in these cases.

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

The CRIM reports annually to **the Municipality** the estimated basic property tax and the tax to be used for the debt service, which will be collected in the fiscal year. The basic tax is advanced to **the Municipality** during such fiscal year. It is the practice to amortize these advances through the subsequent collection by the CRIM of the basic tax from the taxpayers.

The basic property tax advances from the CRIM are recorded in the general fund as other financing sources. As this tax is collected and reported by the CRIM, it is recorded in the general fund as revenue. The property tax received from the Department of Treasury, which is related to the exoneration granted by the Commonwealth of Puerto Rico is reflected as revenue in the general fund.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

2. **PROPERTY TAXES** (Continuation)

The following is a summary of the property tax advances during the current year, which resulted as an account receivable, included in the amount due from other agencies as of June 30, 2004.

Account Receivable:

Amortization through collections of property taxes by the CRIM, 7/1/03 - 6/30/04	\$ 5,887,243
Advanced received, 7/1/03 – 6/30/04	<u>5,513,425</u>
Due from CRIM-2004	<u>\$ 373,818</u>

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, **the Municipality** recognized as an expenditure the operational expenses allocated by the CRIM to **the Municipality**, which amounted to \$85,262 during 2004.

Prior year advances

The outstanding debt from prior years related with the excess of property taxes collected by **the Municipality** amounted to \$579,846 as of June 30, 2004. The term of the financing of this debt is 30 years with a semester installment payment of \$21,918 including interests at 6.1875% and due date of July 1, 2032. The CRIM retains from the property tax advances the corresponding installment payments. 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. The non-current liability unpaid balance has been presented in the Statement of Net Assets because payment is not anticipated to be paid in near future. Also, the current portion of \$8,081 has been presented in the debt service fund for Governmental Fund Financial Statement.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

2. PROPERTY TAXES (Continuation)

Prior year advances (Continuation)

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 advances by the Secretary of the Treasury to **the Municipality** that had not been amortized through the collections of property taxes amounted to \$28,274.

3. CASH, CASH EQUIVALENTS AND INVESTMENTS

Cash, cash equivalent and investment include certificates of deposits amounting to \$2,503,304. **The Municipality's** cash and investments at June 30, 2004, were entirely covered by the Federal Depository Insurance Corporation or by collateral provided by the banks and held by the Department of the Treasury 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 collateralized by the Commonwealth of Puerto Rico.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. **The Municipality** is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. **The Municipality** has invested its funds in interest-bearing bank accounts and short-term certificates of deposit.

4. CONCENTRATION OF CREDIT RISK

The Municipality maintains its cash account in local commercial banks, whose accounts are warranty by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. Deposits in excess of \$100,000 are collateralized by the bank securities to property safeguard such funds.

Nevertheless, Management believes that concentration of credit risks is limited because balances are deposited with high standing financial institutions.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2004

5. MUNICIPAL LICENSE TAXES

The Municipality imposes a volume of business tax pursuant to Act No. 82 of August 30, 1991, on all business entities, which operate within **the Municipality**, which are not exempt from the tax pursuant to the Industrial Incentives Act. The tax is based on gross revenues, as defined by law, computed at the rate of 1.5% for financial institutions and savings and loans associations, 0.5% for all other non-financial organizations.

The minimum gross revenue to file the Volume of Business Tax Declaration is \$5,000 and the minimum tax payable is \$25. The due date to file the Volume of Business Tax Declaration is April 23. **The Municipality** grants a 5% discount, if the taxes are paid on or before of this date. Otherwise, 50% of taxes payable must be paid within the first 15 days of each semester beginning with the first semester ending December 31.

The Municipality recognized an account receivable for the estimated municipal license taxes to be collected during the first three months of next year, but corresponding to current year. Municipal licenses taxes collected prior to June 30, but pertaining to the next fiscal year, are recorded as deferred revenues.

6. INTERFUND TRANSACTIONS

Due From/To Other Funds (Fund Financial Statement)

Interfund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures. However **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, 2004 nor on its beginning balance, which results on a combined difference of \$ 425,581. Therefore, 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 balance.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

7. DUE FROM/TO GOVERNMENTAL AGENCIES

General fund

As of June 30, 2004 balances from (due to) governmental entities of the general fund consists of the following:

<u>Agency</u>	<u>Due from</u>	<u>Due to</u>
Centro de Recaudación Ingresos Municipales (CRIM)	\$ 373,818	\$ -
Electric Puerto Rico Power Authority	34,547	-
Puerto Rico Water and Sewer Authority	-	(2,186)
Human Resources and Employment Department	114,650	415,659
Puerto Rico Telephone Company	-	32,496
General Services Administration	-	12,945
Department of Treasury	-	<u>143,603</u>
Totals	<u>\$ 523,015</u>	<u>\$ 602,517</u>

8. DEBT SERVICE FUND

The revenues of the debt service fund arise from the additional property tax and are recognized when collected and informed by the CRIM (See Note 2). The CRIM retains these collections for the payment of principal and interest of bonds and notes issued by **the Municipality**. Interest income is for the payment of interest or special obligation notes and property taxes are for the debt service requirements of the general obligations bonds and notes.

Principal and interest on these obligations are paid by the Government Development Bank of Puerto Rico from funds obtained from the property taxes.

Expenditures for year 2003-2004 were as follows:

Principal (Note 9)	\$ 450,000
Interest	<u>553,684</u>
	<u>\$1,003,684</u>

MUNICIPALITY OF YABUCOA, PUERTO RICO

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004**

9. INTERGOVERNMENTAL REVENUES

Sources of intergovernmental revenue 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 Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Almost all these intergovernmental revenues are accounted for in the general fund.

10. CAPITAL ASSETS

Government Wide Financial Statements

<u>Capital Assets</u>	<u>Balances</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balances</u>
Governmental Activities:	6/30/03			6/30/04
<i>Non-depreciable assets:</i>				
Land	\$ 230,000	-	-	\$ 230,000
Construction in progress	<u>183,534</u>	<u>1,249,193</u>	<u>-</u>	<u>1,432,727</u>
<i>Total Non-depreciable assets</i>	<u>\$ 413,534</u>	<u>1,249,193</u>	<u>-</u>	<u>1,662,727</u>
<i>Depreciable assets:</i>				
Buildings and improvements	\$ 12,951,381	187	-	\$12,951,568
Infrastructure	1,385,264	651,852		2,037,116
Vehicles, Equipment, Furniture & Fixture	<u>4,213,863</u>	<u>215,953</u>	<u>-</u>	<u>4,429,816</u>
Sub-totals	18,550,508	867,992	-	19,418,500
Less accumulated depreciation	(<u>4,831,735</u>)	(<u>860,829</u>)	(-)	(<u>5,692,564</u>)
<i>Depreciable assets, net</i>	<u>\$ 13,718,774</u>	<u>\$ 7,163</u>	<u>-</u>	<u>\$ 13,725,936</u>
<i>TOTAL CAPITAL ASSETS-NET OF ACCUMULAED DEPRECIATION</i>	<u>\$ 13,760,308</u>	<u>\$1,256,356</u>	<u>-</u>	<u>\$ 15,388,663</u>

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

10. CAPITAL ASSETS (continuation)

Government Wide Financial Statements (continuation)

Depreciation expense was charged to functions as follows:

General Government	\$ 70,680
Public Safety	114,111
Public Ways and Facilities	435,068
Health, Sanitation and Welfare	16,403
Culture and Recreation	213,095
Public Instruction	<u>11,472</u>
Total	<u>\$ 860,829</u>

11. PENSION PLAN

Plan Description

Regular employees of **the Municipality** contribute to a cost sharing multiple-employer defined benefit retirement plan administered by the Employee's Retirement System of the Commonwealth of Puerto Rico (and reported as a component unit of the Commonwealth of Puerto Rico) and its instrumentalities (ERS). The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico.

The system provides retirements pensions, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefit depends upon age at retirement and the number of years of creditable service. Benefits are vest after ten years of plan participation.

MUNICIPALITY OF YABUCOA, PUERTO RICO

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004**

11. PENSION PLAN (continuation)

Plan Description (continuation)

Member who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service 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, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65% of the average compensation, as defined; otherwise they will receive 75% of the average compensation, as defined. No benefit are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation required employees to contribute 5.775% for the first \$550 o their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participants' gross salary.

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

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

11. **RETIREMENT SYSTEM** (continuation)

Plan Description (continuation)

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by the ERS together with those of the current defined plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employees' salary up to a maximum of 10%) will be invested in account which either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees) or, (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Funding Policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employer and other contributing entities are established or may be amended. The required contributions made by **the Municipality** were based on percentages established by the Administrator of the System. Such percentages were not based on actuarial studies as required by generally accepted accounting principles. An actuarial computation of the annual contribution applicable to **the Municipality** has not been prepared. Accordingly, the amounts by which the actual contributions differ from the required actuarial contributions are not known. **The Municipality's** total payroll for the fiscal year 2004 was approximately \$4,953,022 of which \$1,977,962 were subject to the ERS. Total employer and employee contribution during the year ended June 30, 2004 amounted to approximately \$186,456 and \$163,319, respectively.

ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS at G.P. O. Box 42003, San Juan, Puerto Rico 00940.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

11. RETIREMENT SYSTEM (continuation)

Actuarial Valuation

The actuarial determined present value of benefits accrued as of July 1, 2000 (latest date available) for the ERS as whole, determined through an actuarial valuation performed at such date, amounted to \$9.5 billion. The net assets available for benefits at such date were \$2.1 billion, resulting in an excess of accrued benefits over net assets available (actuarial deficiency) of \$7.4 billion. This information is not available by each participant government agencies nor municipalities. Net assets of the System consist principally of investments in stocks and bonds and loans to participants. The projected unit credit actuarial cost method was used for the actuarial calculation. Significant assumptions were as follows:

- | | |
|--|---|
| a) Interest rate | 8.5% a year |
| b) Salary increases | 5.0% a year |
| c) Mortality | GAM'83 Mortality Table set forward two years. |
| d) Termination | Medium Turnover Table commensurate with anticipated experience. |
| e) Disability | 65% of Third Railroad Retirement Table Rates. |
| f) Retirement age | Graded scale of retirement ages commensurate with anticipated experience. |
| g) Proportion of participants with spouses | 80% of participants assumed to be married, with wives assumed to be four years younger than husbands. |
| h) Number of employees electing higher contributions | 15% of retiring employees assumed to pay retroactive contributions at retirement. |
| i) Cost-of-living adjustment | 3% every third year |

MUNICIPALITY OF YABUCOA, PUERTO RICO

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004**

12. LONG TERM LIABILITIES

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

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds and Notes Payable	\$ 9,909,000	\$ 750,000	\$ 450,000	\$10,209,000	\$480,000
Compensated Absences	733,750	-	17,253	716,497	82,418
Landfill Obligation	1,200,000	-	-	1,200,000	-
Claims and Judgments	225,000	-	-	225,000	-
Property Tax Advances	619,688	-	19,650	600,038	8,081
Health Reform Liability	666,070	-	201,720	464,350	-
Legal Settlement	642,477	-	87,815	554,662	87,815
Income Tax Withholding	92,054	-	45,601	46,453	45,600
Guarantee Liability-CRIM	<u>446,670</u>	<u>-</u>	<u>41,966</u>	<u>404,704</u>	<u>106,663</u>
Total	<u>\$14,534,709</u>	<u>\$ 750,000</u>	<u>\$ 864,005</u>	<u>\$14,420,704</u>	<u>\$810,577</u>

a. Bonds and Notes Payable

The following is a summary of the long-term debt transactions for the year ended June 30, 2004:

Debt at June 30, 2003	\$ 9,909,000
Add: Issuance of new debt	750,000
Deduct: Current principal amortization	<u>(450,000)</u>
Debt at June 30, 2004	<u>\$10,209,000</u>

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

a. Bonds and Notes Payable (continuation)

Long-term debt at June 30, 2004 is composed of the following:

General Obligations-Bonds and Notes:

Series of 1986, \$610,000 payable in annual principal installments ranging from \$14,000 to \$43,000 until January 1, 2011; with interest rate at 5%.	\$ 258,000
Series of 1986, \$400,000 payable in annual principal installments ranging from \$11,000 to \$31,000 until January 1, 2011; with interest rate at 6%.	181,000
Series of 1989, \$225,000 payable in annual principal installments ranging from \$4,000 to \$18,000 until January 1, 2014; with interest rate at 6%.	134,000
Series of 1991, \$657,000 payable in annual principal installments ranging from \$16,000 to \$47,000 until January 1, 2016; with interest rate at 5%.	433,000
Series of 1991, \$238,000 payable in annual principal installments ranging from \$6,000 to \$17,000 until January 1, 2016; with interest rate at 5%.	160,000
Series of 1992, \$510,000 payable in semiannual principal installments ranging from \$20,000 to \$60,000 until July 1, 2006; with variable interest rate from 4.163% to 6.363%.	115,000
Series of 1994, \$2,080,000 payable in semiannual principal installments ranging from \$45,000 to \$195,000 until July 1, 2014; with variable interest rate from 5.1% to 7.25%.	1,425,000

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

a. Bonds and Notes Payable (continuation)

General Obligations-Bonds and Notes (Continuation):

Series of 1994, \$106,000 payable in annual principal installments ranging from \$2,000 to \$8,000 until January 1, 2019; with interest rate at 4.5%.	81,000
Series of 1994, \$36,000 payable in annual principal installments ranging from \$1,000 to \$3,000 until January 1, 2019, with interest rate at 4.5.	27,000
Series of 1996, \$120,000 payable in semiannual principal installments ranging from \$5,000 to \$15,000 until July 1, 2011; with variable interest rate from 5% to 8%.	75,000
Series of 1997, \$3,310,000 payable in semiannual principal installments ranging from \$75,000 to \$305,000 until July 1, 2017; with variable interest rate from 5% to 7.5%.	2,640,000
Series of 2001, \$600,000 payable in semiannual principal installments ranging from \$5,000 to \$50,000 until July 1, 2026; with variable interest rate from 5% to 8%.	575,000
Series of 2002, \$1,910,000 payable in semiannual principal installments ranging from \$5,000 to \$295,000 until July 1, 2027; with interest rate at 5%.	1,900,000
Series of 2002, \$680,000 payable in semiannual principal installments ranging from \$10,000 to \$50,000 until July 1, 2027; with variable interest rate from 5% to 6.5%.	660,000

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

a. Bonds and Notes Payable (continuation)

General Obligations-Bonds and Notes (Continuation):

Series 2002, \$230,000 payable in semiannual principal installments ranging from \$5,000 to \$20,000 until July 1, 2027; with variable interest rate from 5% to 6.5%.	220,000
Series 2002, \$300,000 payable in semiannual principal installments ranging from \$5,000 to \$30,000 until July 1, 2027; with variable interest rate from 5% to 6.5%.	290,000
Series 2002, \$335,000 payable in semiannual principal installments ranging from \$5,000 to \$25,000 until July 1, 2027; with variable interest rate at 5.0% to 6.5%.	325,000
Series 2002, \$255,000 payable in semiannual principal installments ranging from \$30,000 to \$45,000 until July 1, 2010; with variable interest rate at 5.0% to 6.5%.	225,000
Series 2002, \$190,000 payable in semiannual principal installments ranging from \$5,000 to \$15,000 until July 1, 2028; with variable interest rate at 5.0% to 6.5%.	185,000
Series 2002, \$305,000 payable in semiannual principal installments ranging from \$5,000 to \$25,000 until July 1, 2028; with variable interest rate at 5% to 6%.	<u>300,000</u>
Total debts of governmental	\$10,209,000
Less current portion due in fiscal year ended June 30, 2005	(<u>480,000</u>)
Long-term portion	<u>\$ 9,729,000</u>

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

a. Bonds and Notes Payable (continuation)

The annual requirements to amortize the general long-term debt outstanding at June 30, 2004, including interest are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 480,000	\$ 590,607	\$ 1,070,607
2006	511,000	613,578	1,124,578
2007	476,000	573,083	1,049,083
2008	522,000	545,862	1,067,862
2009	550,000	509,758	1,059,758
Subsequent year	<u>7,670,000</u>	<u>3,598,962</u>	<u>11,268,962</u>
TOTALS	<u>\$10,209,000</u>	<u>\$6,431,850</u>	<u>\$16,640,850</u>

The Municipality is subject to certain laws of the Commonwealth of Puerto Rico, which limit the amount of bond obligations that can be issued to 10% of the assessed valuation of the property located at **the Municipality**.

b. Compensated Absences

The liability for compensated absences was recorded in the Government-wide financial statements. The balance consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which sick leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

The governmental-wide Statement of Net Assets includes approximately \$458,558 of accrued vacation and approximately \$256,598 of accrued sick leave benefits.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

b. Landfill Obligation

State and federal laws and regulations require **the Municipality** to carry out a 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 the accordance with GASB Statement No. 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, 2004. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. However, **the Municipality** has not determined the estimated landfill post-closing costs that will be recognized by the GASB Statement No. 18. Accordingly, no provision for liability, if any, has been made on the accompanying governmental-wide financial statements. The balance of closure costs of \$1,200,000 is reported in the governmental-wide financial statement because it will not be funded with available expendable financial resources at June 30, 2004.

The Municipality expects to finance this obligation with an assignment of the central government and federal funds. In addition, the Solid Waste Disposal Administration of Puerto Rico approved to **the Municipality** the amount of \$1,000,000 to be used on the disposition of municipal solid waste landfill closing cost. This amount has been recorded into the debt service fund.

c. Claims and Judgments

The Municipality's legal counsel did not provide us with a complete discussion and evaluation of all pending or threatened litigation as of the date of our audit.

The Statement of Net Assets included the same amount of \$225,000 recorded on prior year financial statement for anticipated unfavorable judgment as an estimate of the probable liability. **The Municipality** believes that the ultimate liability in excess of amounts provided would not be significant.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

c. Claims and Judgments (continuation)

However, as discussed in the first paragraph, the accompanying governmental-wide financial statement do not include additional adjustments, if any, that could result from the pending and threatened litigation or resolution of legal proceedings in the discovery stage in excess of this amount.

d. Property Tax Advances

This amount represents the balance owed to CRIM and Treasury of Department of Puerto Rico at June 30, 2004 as described in Note 2, which will be repaid through a property tax collection obtained by the CRIM as authorized by law and as explained in this Note. The total property tax advances as of June 30, 2004 was \$600,038.

e. Health Reform Insurance Liability

The amount due to the Puerto Rico Health Insurance Administration is related with a unpaid balance from year ended at June 30, 1997 accordingly with the implementation of Act No. 72 of September 7, 1993, which establishes contributions for the medical services covered by the Health Reform based on the operational budget of the municipalities. The unpaid balance is amortized through the proportional participation of the municipalities to the annual increase in electronic lottery income which is collected and withheld by the Treasury of Department of Puerto Rico.

f. Legal Settlement

Represent the amount due to the Treasury Department of Puerto Rico related with a legal settlement. This debt is under a non-interest bearing payment plan with a monthly installment of \$7,400, which is withheld by the CRIM through the intergovernmental funds and property tax collection.

g. Income Tax Liability

Represent the amount due to the Treasury Department of Puerto Rico related with prior year income tax withholdings. This debt is under a non-interest bearing payment plan with a monthly installment of \$3,800, which is withheld by the CRIM through the intergovernmental funds and property tax collection.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2004

12. LONG TERM LIABILITIES (continuation)

h. Guarantee Liability – CRIM (Law #146)

The Municipality has the obligation to guarantee a line of credit that the Municipal Revenue Collection Center (CRIM) is negotiated 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** guaranteed the maximum amount of \$446,669 of this line of credit. This term of the financing agreements is 30 years with a due date of December 1, 2032 with an interest rate of 6.1875%. The source revenue to amortize this debt represents the net increase of .48% of the intergovernmental funds collected from central government and property tax collection. This fund is withheld by CRIM. The unpaid balance as of June 30, 2004 was \$404,704.

13. CONTINGENCIES AND COMMITMENTS

a. Contingencies

Litigation

Litigation represents the ultimate liability, if any, of **the Municipality** as a defendant in various lawsuits, not covered by insurance.

The Municipality has been named as a defendant or co-defendant in various lawsuits. They primarily relate to accidents and personal injuries, accidents and employee claims of alleged unjustified dismissal or breach of contracts.

The Municipality believes it has meritorious defenses against these legal actions and is contesting them vigorously. In addition, **the Municipality** considers that these claims are filed in amounts far greater than those that can be reasonably expected to be agreed on with claimants or awarded by a court. Nonetheless, a provision of \$225,000 has been recorded in the wide financial statements.

MUNICIPALITY OF YABUCOA, PUERTO RICO

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004

13. CONTINGENCIES AND COMMITMENTS (continuation)

a. Contingencies (continuation)

CRIM

In December 2001, the CRIM refinanced an approximately \$70 millions long-term debt with a financial institution related with the Land Information Management System (LIMS) project. The loan includes the interests at 5.95% for a 10 years period ending in 2011 and it is collateralized proportionally with the total "ad-valorem" personal and real property of all the municipalities. Total contribution made by **the Municipality** as year ended June 30, 2004, amounted \$76,013.

Federal Financial Assistance

The Municipality participates in a number of federal financial assistance programs. Although **the Municipality's** grant programs have been audited in accordance with the provisions of the Single Audit Act of 1984, as amended, during the year ended June 30, 1996, these programs are still subject to financial and compliance audits and resolution of previously identified questioned costs. These grants are also subject to audit on behalf of the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant program requirements, **the Municipality** may be required to reimburse to the grantor agency. Accordingly, the Administration's compliance with applicable grant requirements will be established at some future date. Nevertheless, **the Municipality's** management expects the amount of expenditures, which may be disallowed by the granting agencies from such audits, to be immaterial.

Health Care Costs

During the year ended June 30, 2000 the Commonwealth of Puerto Rico imposed to the municipalities an annual contribution to subsidy the cost of the implementation and administration of the Health Care Reform. Such contribution is withheld from the intergovernmental funds collected form central government and property tax collection. Total contribution made by **the Municipality** as year ended June 30, 2004, amounted \$415,902.