OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL
ÁREA DE ARCHIVO DIGITAL

MUNICIPIO DE ARROYO
AUDITORÍA 2014-2015
30 DE JUNIO DE 2015

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARROYO

BASIC FINANCIAL STATEMENTS
WITH ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

Year Ended June 30, 2015

Municipality of Arroyo, P.O. Box 477, Arroyo, Puerto Rico 00714

Hon. Eric Bachier Román

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López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

Member of:
- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Arroyo, Puerto Rico (Municipality), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. 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 the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluation the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Calle Paraná #1686, El Cerezal, San Juan, P.R. 00926-3144 – Tel. (787) 777-8044 / Fax (787) 764-9377

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Basis for Adverse of Opinion on the Government – Wide Financial Statements

Due to the inappropriateness of the Municipality's accounting records over fixed assets, we were unable to obtain adequate audit evidence regarding the amounts at which capital assets, accumulated depreciation and net investment in capital assets, are recorded in the accompanying statement of net position at June 30, 2015, stated at $57,530,702, $20,484,387 and $29,045,174. Depreciation expense has been recorded for those assets in the fiscal year 2015. Accounting principles generally accepted in the United States of America require that those assets be capitalized and depreciated, which would increase the assets, net position and expenses of the governmental activities.

Besides, the Municipality did not comply with the requirements established by Statement No. 18, *"Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs",* issued by the Governmental Accounting Standards Board and the regulations set forth by the U.S. Environmental Protection Agency (EPA). At June 30, 2015, the accompanying statement of net position presents a liability for post-closure care costs of the Municipality's solid waste landfill of $1,694,062. However, this estimate has not been made based a study in conformity with the regulatory requirements established by the EPA *"Solid Waste Disposal Facility Criteria"*. The amount by which departure would affect the liabilities, net position and expenses of the governmental activities is not reasonably determinable.

The Municipality's pension plan administrator has not provided the audited actuarial and financial information necessary for the proper recognition and reporting of its net pension liability as of June 30, 2015. As a result, management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68. Accounting principles generally accepted in the United States of America require that governmental employers whose employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plans recognize a liability and pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of the collective net pension liability, pension expense, deferred outflows of resources and deferred inflows of resources reported by the pension plan trust. The amount by which this departure would affect the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the Municipality's governmental activities has not been determined.

In addition, the Municipality's financial statements do not disclose the descriptive information about the pension plans through which the pensions are provided required by the GASB Statement No. 68 for cost-sharing employers. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

As a result of these matters, we were unable to determine whether any audit adjustments might have been found necessary in respect of recorded or unrecorded capital assets and liability for post-closure care costs and the elements making up the Statement of Net Position and Statement of Activities.

Adverse of Opinion – Government – Wide Financial Statements

In our opinion, because of the significance of the matter discusses in the "Basis for Adverse Opinion on Governmental Activities" paragraph, the financial statements referred to above do not present fairly the financial position of the governmental activities of the Municipality of Arroyo, Puerto Rico, as of June 30, 2015, or the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages **5** through **14** and **55** be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted historical pension information, as stated in GASB Statement No. 68, that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

The Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 1, 2016, on our consideration of the Municipality of Arroyo' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Municipality of Arroyo' internal control over financial reporting and compliance.

López-Vega, CPA, PSC

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 1, 2016

Stamp No. 2705512 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

This discussion and analysis of the **Municipality of Arroyo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2015. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. This document also includes comparative data with prior year as this information was available for the fiscal year ended on June 30, 2014. This MD&A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. an evaluation of its financial condition as of the end of fiscal year 2014-15 compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities; and
5. a basis to assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2015 constitute factual evidence of the Municipality's economic situation by the end of such year. The following comments deserve special mention:

1. Total assets of the Municipality as of the end of fiscal year 2014-2015 amounted to $43,641,954 which represents an increase of 3% compared to prior fiscal year.
2. At the end of fiscal year 2015, total liabilities amounted to $20,613,239. Out of said amount, $16,924,399 corresponded to long-term liabilities of which $9,150,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self-generated revenues.
3. Total net position of the Municipality as of the end of fiscal year 2014-2015 amounted to $23,028,715 which represents an increase of 10% compared to prior fiscal year.
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to $16,129,830 derived from the following sources: $199,644 from charges for services; $2,462,246 from operating grants and contributions; $2,254,408 from capital grants and contributions obtained from other sources, and $11,213,532 from general revenues available.

FINANCIAL HIGHLIGHTS (CONTINUED)

5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to $14,007,418.

6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Position figure by $2,122,412.

7. As of the close of the current fiscal year, the Municipality's Governmental Funds reported combined ending fund balances of $2,449,488.

8. As the end of the current fiscal year, the Municipality's general fund balance reflects a deficit of $985,126, compared to a fund deficit of $1,009,760 in the prior fiscal year. After the reclassification debt, (Puerto Rico Aqueduct and Sewer Authority - Debt Agreement) from Fund Financial to Governmental Wide; the beginning fund deficit was 1,009,760.

9. The actual General Fund budgetary activities resulted in an unfavorable balance of ($573,796).

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2015. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Position reflects information of the Municipality as a whole on a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year.

USING THIS ANNUAL REPORT

This annual report consists of a series of new financial statements with a change in 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.

GOVERNMEMENT – 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.

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

The Statement of Activities presents information showing how the Municipality's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities 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

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

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.

FUND FINANCIAL STATEMENTS (CONTINUED)

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, underground pipes [unless associated with a utility], 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 demonstrated 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 condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

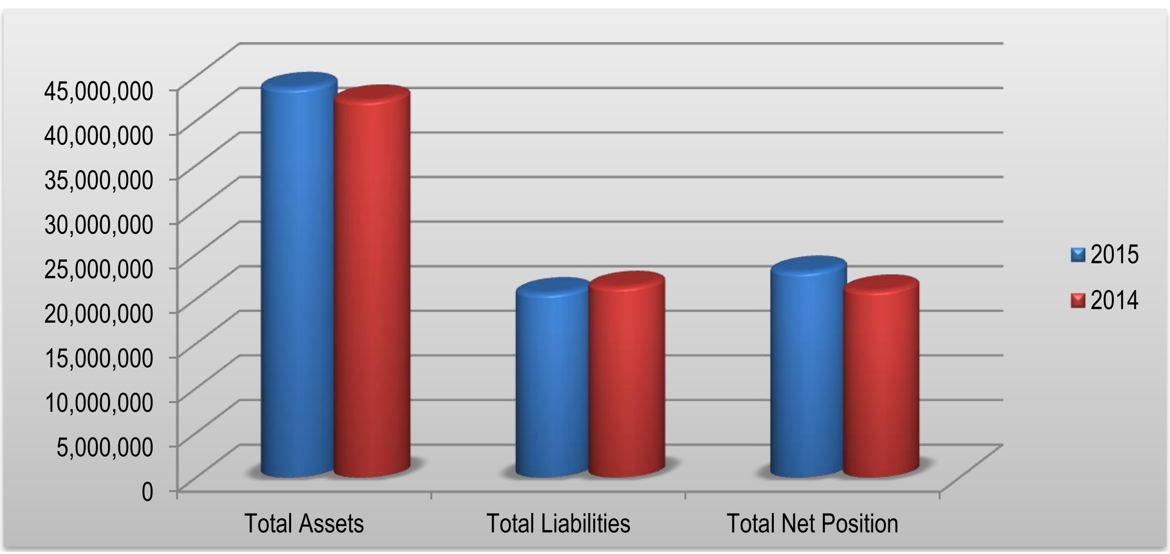
FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Position

The Statement of Net Position serves as an important indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Municipality of Arroyo, primary government assets exceeded total liabilities by $23,028,715 at the end of 2015, as compared with $20,906,303, which reflect an increase of $2,122,412 when compared with previous fiscal year. The following condensed Statements of Net Position of the Primary Government shows on a comparative basis the most important components of the $2,122,412 increase reflected in the Net Position figure.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Condensed Statements of Net Position	2015	2014	Change	%
Current and other assets	$ 6,595,639	$ 7,529,092	$ (933,453)	-12%
Capital assets	37,046,315	34,702,693	2,343,622	7%
Total assets	43,641,954	42,231,785	1,410,169	3%
Current and other liabilities	3,688,840	3,236,852	(451,988)	14%
Long-term liabilities	16,924,399	18,088,630	(1,164,231)	-6%
Total liabilities	20,613,239	21,325,482	(712,243)	-3%
Net investment in capital assets	29,045,174	25,753,653	3,291,521	13%
Restricted	3,290,861	4,752,692	(1,461,831)	-31%
Unrestricted deficit	(9,307,320)	(9,600,042)	292,722	-3%
Total net position	$ 23,028,715	$ 20,906,303	$ 2,122,412	10%



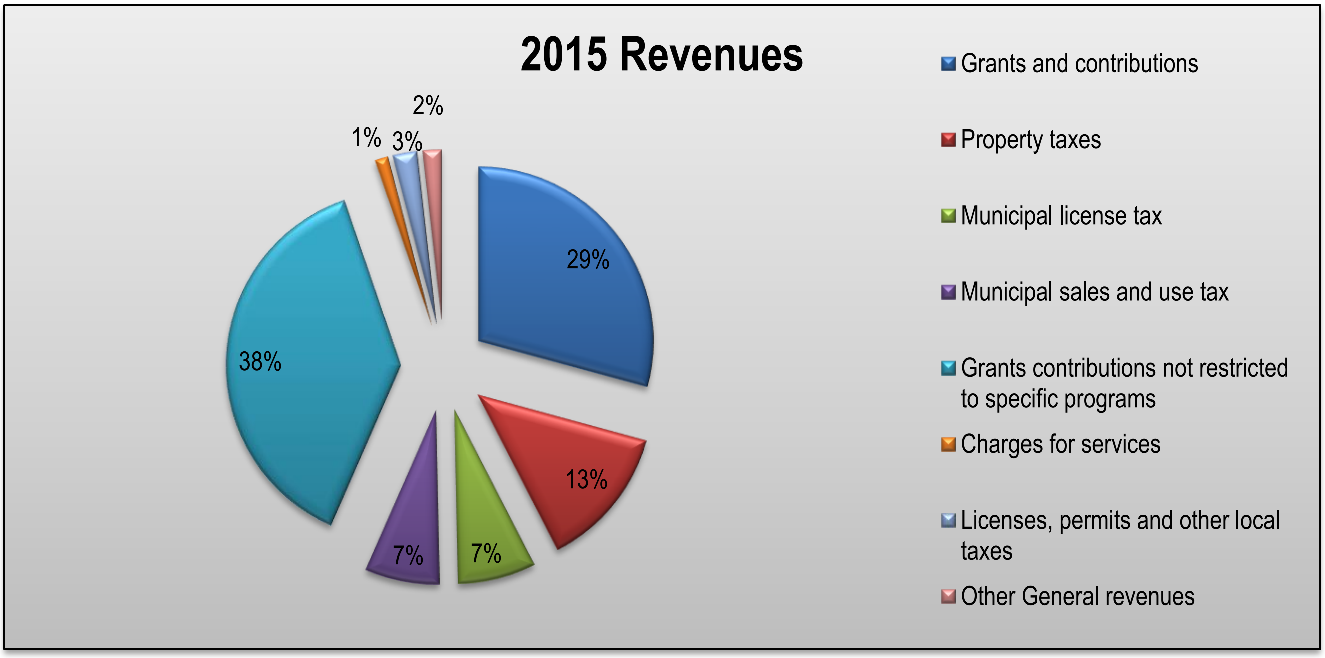
FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

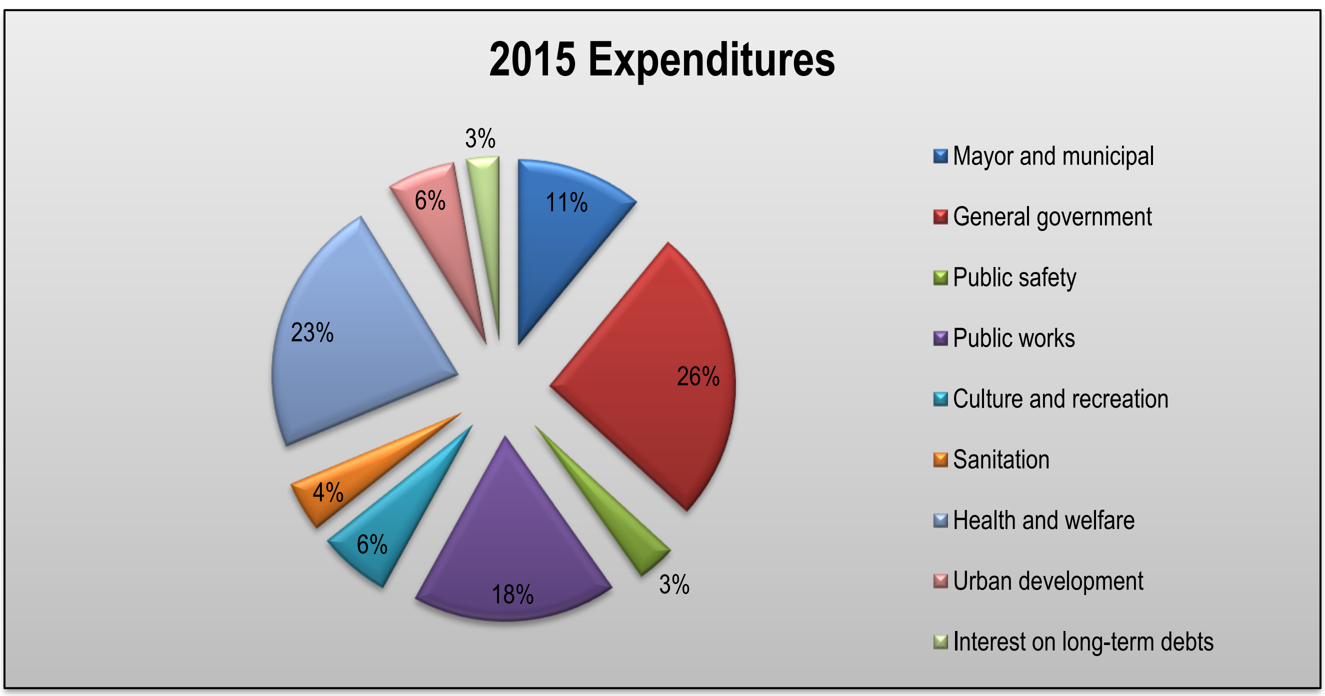
Changes in Net Position

The Municipality's net position increased by $2,122,412. Approximately thirty percent (30%) of the Municipality's total revenue came from taxes, while sixty-seven percent (67%) resulted from grants and contributions, including federal aid. Charges for Services, Rent and miscellaneous provided three (3%) of total revenues. The Municipality's largest expenses included items such as general government, health and welfare services, public works, urban development and culture and recreation. The following table and graphic presentation includes in absolute and relative terms, the composition of revenues and expenses for the fiscal years ended on June 30, 2014 and 2015. Such analysis helps the reader to evaluate the Municipal administration performance in the administration of its current financial operations.

Condensed Statements of Activities	2015	2014	Change	%
Program revenues:				
Charges for services	$ 199,644	$ 163,267	$ 36,377	22%
Operating grants and contributions	2,462,246	2,444,802	17,444	1%
Capital grants and contributions	2,254,408	1,892,406	362,002	19%
General revenues:				
Property taxes	2,130,269	1,927,170	203,099	11%
Municipal sales and use tax	1,111,010	1,103,892	7,118	1%
Municipal license tax	1.165,084	1,071,583	93,501	9%
Licenses, permits and other local taxes	363,733	112,601	251,132	223%
Grants and contributions not restricted to specific programs	6,159,656	7,267,935	(1,108,279)	-15%
Rent	117,939	63,209	54,730	87%
Miscellaneous	165,841	533,395	(367,554)	-69%
Total revenues	16,129,830	16,580,260	(450,430)	-3%
Expenses:				
Mayor and municipal	1,537,430	1,489,634	47,796	3%
General government	3,616,652	5,898,380	(2,281,728)	-39%
Public safety	479,347	441,958	37,389	8%
Public works	2,494,248	1,982,262	511,986	26%
Culture and recreation	880,783	825,032	55,751	7%
Sanitation	617,616	538,213	79,403	15%
Health and welfare	3,155,932	2,900,527	255,405	9%
Urban development	832,313	652,146	180,167	28%
Interest on long-term debt	393,097	414,768	(21,671)	-5%
Total expenses	14,007,418	15,142,920	(1,135,502)	-7%
Change in net position	2,122,412	1,437,340	685,072	48%
Net position, beginning of year, as restated	20,906,303	19,468,963	(1,437,340)	7%
Net position, end of year	$ 23,028,715	$ 20,906,303	$ 2,122,412	10%

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)





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 spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unrestricted 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 fund balances of $2,449,488, a decrease of $1,254,123 in comparison with the prior year, as restated. The combined fund balances include restricted fund balances amounting to $3,458,228. This is the portion of fund balance that reflects resources that are subject to externally enforceable legal restrictions 1) to pay for specific program purposes (including capital projects and operational purposes) ($2,066,016); 2) to pay debt services ($730,112) and for housing purposes ($662,100). The Municipality has committed $352,972, of the fund balance, for construction purposes.

Governmental funds include the General Fund, which is the main operating fund of the Municipality. As of June 30, 2015, the General Fund has an accumulated deficit of $985,126 compared with prior fiscal year with deficit of $1,009,760, as restated.

GENERAL FUND BUDGETARY HIGHLIGHTS

During fiscal year 2014-2015, the Municipal Legislature approved revisions to the operational budget that was prepared in accordance to the analysis of previous year's results. Despite of the balance budget, the expected amounts of revenues were not collected, as reflected in exhibit. Budgetary Comparison Schedule-General Fund attached here to. The Municipality of Arroyo current year operation had a deficiency of revenues over expenses of ($573,796).

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2015, amounted to $29,045,174 which upon deduction of accumulated depreciation in the amount of $20,484,387 produced a net book value attributable to capital assets in the amount of $37,046,315. Said investment includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. Infrastructure assets are composed of items such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items. Depreciation charges for the year totaled $219,401. The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

Debt Administration

The Commonwealth Legislature of Puerto Rico 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". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such Municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues.

Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

As mentioned in previous paragraphs in the notes of the Municipality's financial statements attached hereto, during the earlier months of the present year 2014, the Commonwealth Legislature approved Acts number 18 and 19. Through such legislation, the cash flow produced from collections by the municipalities of the sales and use taxes is completely restructured thru a creation of the Municipal Financial Corporations (known as COFIN in the Spanish anachronism) to provide additional liquidity to the Puerto Rico Government Development Bank's (GDB) weakened cash position. The new created affiliate to the GDB will receive those collections, and will assume the total indebtedness incurred by municipalities as of June 30, 2014. A portion estimated in .03% of total collections will be used for the payment of debt services requirement. In order to protect the municipality's cash flow, the GDB, on a monthly basis, will make advances to the municipalities included in the new arrangement, free of financing charges, equivalent to the monthly collections from the previous year. In the meantime, total liabilities incurred by de municipalities using the Municipal Redemption Fund will be refinanced and GDB will recover its borrowed cash.

It is anticipated that under the arrangement, the municipalities will recover the total 1% of uses and sales tax and will get the assurance of future sources of financing either from GDB, from the new created affiliate or private financing institutions. Furthermore, the former Municipal Development Funds and the Bond Redemption funds will prevail under the new legislation. Its funding will be transferred from the .5% added to the Municipal Tax to be collected by the Secretary of the Treasury which will be first transfer to COFINA, which, upon compliance with its debt service obligation, will transfer .4% to each indicated municipal funds and .1% to a Municipal Improvement Fund, whose distribution to Municipalities will be determined by the Puerto Rico Legislative Assembly.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2015-2016.

FINAL COMMENTS

The Municipality is a governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. It further contemplates to maintain or improve its current levels of Net Position as indicative of a strong financial position which has been identified as one of the main short and long-term objectives of the Municipality.

The new GASB Statement No. 68, *Accounting and Financial Reporting for Pensions, an amendment to GASB Statement No. 27,* was effective for the fiscal year ended June 30, 2015. This Statement requires participants of cost-sharing defined benefit pension plans that are administered through trusts that comply with certain criteria to recognize in their financial statements their proportionate share of the collective net pension liability, net pension expense and deferred outflows/inflows of resources related to pensions. The Municipality's pension plan is administered by the Employees Retirement System Administration (ESR). The ESR has not issued its audited financial statements for the fiscal year ended June 30, 2014 (the plan's measurement date), and as a result, the Municipality of Salinas could not comply with the accounting and financial reporting requirements set forth in GASB Statement No. 68. Consequently, the Municipality's financial statements do not report or disclose the required information for its pension plan for the fiscal year 2014-15.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, 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.

		Governmental Activities
Assets		
Cash and cash equivalents	$	1,593,266
Cash with fiscal agents		2,543,881
Restricted cash and funded reserves		678,306
Accounts receivable:		
Property tax		130,422
Municipal sales and use tax		20,065
Construction excise tax		-
Federal grants		845,879
Intergovernmental		746,426
Miscellaneous		10,362
Other assets		27,032
Capital assets		
Land, improvements, and construction in progress		57,530,702
Other capital assets, net of depreciation		(20,484,387)
Total capital assets		37,046,315
Total assets		43,641,954
Liabilities		
Bank overdraft		646,111
Accounts payable and accrued liabilities		1,349,326
Bonds and Notes Payable		325,000
Intergovernmental		273,418
Interest payable		134,246
Unearned revenues		960,739
Noncurrent liabilities:		
Due within one year		1,446,368
Due in more than one year		15,478,031
Total liabilities		20,613,239
Net Position		
Net investment in capital assets		29,045,174
Restricted for:		
Housing Project		36,670
Debt service		730,112
Other purposes		2,524,079
Unrestricted (deficit)		(9,307,320)
Total net position	$	23,028,715

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Position: Governmental Activities
Mayor and Municipal Legislature	$ (1,537,430)	$ -	$ -	$ -	$ (1,537,430)
General government	(3,616,652)	-	-	-	(3,616,652)
Public safety	(479,347)	-	2,328	-	(477,019)
Public works	(2,494,248)	-	311,053	-	(2,183,195)
Culture and recreation	(880,783)	-	-	-	(880,783)
Sanation	(617,616)	130,448	-	-	(487,168)
Health and welfare	(3,155,932)	69,196	2,148,865	-	(937,871)
Urban development	(832,313)	-	-	2,254,408	1,422,095
Interest on long-term debt	(393,097)	-	-	-	(393,097)
Total governmental activities	$ (14,007,418)	$ 199,644	$ 2,462,246	$ 2,254,408	(9,091,120)

General revenues:	
Taxes:	
Property tax, levied for general purposes	1,456,616
Property tax, levied for debt services	673,653
Municipal license tax	1,165,084
Municipal sales and use tax	1,111,010
Construction excise tax	363,733
Intergovernmental	6,159,656
Rent	117,939
Miscellaneous	165,841
Total general revenues	11,213,532
Change in net position	2,122,412
Net position - beginning, as restated	20,906,303
Net position - ending	$ 23,028,715

	General Fund	Housing Project Brisas de Arroyo Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Cash and cash equivalents	$ -	$ 7,179	$ -	$ 1,586,087	$ 1,593,266
Cash with fiscal agents	376,587	-	1,139,948	1,027,346	2,543,881
Restricted cash and funded reserves	-	678,306	-	-	678,306
Accounts receivable:					
Property taxes	81,012	-	49,410	-	130,422
Municipal sales and use tax	20,065	-	-	-	20,065
Construction excise tax	-	-	-	-	-
Federal grants	4,502	-	-	841,377	845,879
Intergovernmental	491,539	-	-	254,887	746,426
Miscellaneous	-	10,362	-	-	10,362
Due from other funds	1,162,967	-	-	471,739	1,634,706
Other assets	-	27,032	-	-	27,032
Total assets	$ 2,136,672	$ 722,879	$ 1,189,358	$ 4,181,436	$ 8,230,345
Liabilities, Deferred Inflows of Resources and Fund balances (deficit)					
Bank overdraft	$ 646,111	$ -	$ -	$ -	$ 646,111
Accounts payable and accrued liabilities	524,083	60,779	-	764,464	1,349,326
Bonds and notes payable	-	-	325,000	-	325,000
Accrued interest	-	-	134,246	-	134,246
Due to:					
Commonwealth government	273,418	-	-	-	273,418
Other funds	471,739	-	-	1,162,967	1,634,706
Deposits and prepayment liabilities	-	-	-	-	-
Unearned revenues:					
Municipal license tax	749,136	-	-	-	749,136
Federal grants	-	-	-	211,603	211,603
Total liabilities	2,664,487	60,779	459,246	2,139,034	5,323,546
Deferred Inflows of Resources					
Unavailable revenues:					
Intergovernmental	457,311	-	-	-	457,311
Total Deferred Inflows of Resources	457,311	-	-	-	457,311
Fund balances (deficit):					
Restricted	23,614	662,100	730,112	2,042,402	3,458,228
Committed	352,972	-	-	-	352,972
Unassigned	(1,361,712)	-	-	-	(1,361,712)
Total fund balances (deficit)	(985,126)	662,100	730,112	2,042,402	2,449,488
Total liabilities, deferred inflows of resources and fund balances (deficit)	$ 2,136,672	$ 722,879	$ 1,189,358	$ 4,181,436	$ 8,230,345

	General Fund	Housing Project Brisas de Arroyo Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Property taxes	$ 1,375,604	$ -	$ 673,653	$ -	$ 2,049,257
Municipal license taxes	1,165,084	-	-	-	1,165,084
Municipal sales and use tax	652,222	-	458,788	-	1,111,010
Intergovernmental	6,692,363	-	-	1,349,312	8,041,675
Construction excise tax	363,733	-	-	-	363,733
Rent of property	96,465	21,474	-	-	117,939
Federal grants	-	470,893	-	2,896,234	3,367,127
Charges of services	130,448	-	-	69,196	199,644
Miscellaneous	156,793	9,048	-	215	166,056
Total revenues	10,632,712	501,415	1,132,441	4,314,957	16,581,525
Expenditures					
Current:					
Mayor and Municipal Legislature	$ 1,537,430	$ -	$ -	$ -	$ 1,537,430
General government	4,184,936	-	-	338	4,185,274
Public safety	445,703	-	-	27,537	473,240
Public works	2,057,201	-	-	437,047	2,494,248
Culture and recreation	861,404	-	-	12,220	873,624
Sanitation	617,616	-	-	-	617,616
Health and welfare	989,380	293,056	-	1,765,880	3,048,316
Urban development	249,908	-	-	3,048,230	3,298,138
Debt service:					
Principal	-	57,469	355,000	-	412,469
Interest	-	123,560	269,537	-	393,097
Total expenditures	10,943,578	474,085	624,537	5,291,252	17,333,452
Excess (deficiency) of revenues over (under) expenditures	(310,866)	27,330	507,904	(976,295)	(751,927)
Other financing sources (uses)					
Payment of long-term debt- P.R.E.P.A.	(502,196)	-	-	-	(502,196)
Transfers in	1,015,870	-	31,950	472,294	1,520,114
Transfers out	(178,174)	-	(877,972)	(463,968)	(1,520,114)
Total other financing sources (uses)	335,500	-	(846,022)	8,326	(502,196)
Net change in fund balances (deficit)	24,634	27,330	(338,118)	(967,969)	(1,254,123)
Fund balance (deficit), beginning as restated	(1,009,760)	634,770	1,068,230	3,010,371	3,703,611
Fund balance (deficit), ending	$ (985,126)	$ 662,100	$ 730,112	$ 2,042,402	$ 2,449,488

Total Fund Balances - Governmental Funds		$ 2,449,488
Amounts reported for Governmental Activities in the Statement of Net Position are different because:		
Capital Assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. In the current period, these amounts are:		
Capital Assets	57,530,702	
Accumulated depreciation	(20,484,387)	
Total Capital Assets		37,046,315
Other assets are not available to pay current-period expenditures and, therefore, are reported as deferred inflows of resources in the funds:		
Due from Commonwealth Government:		
Municipal Revenue Collection Center (CRIM)	81,012	
P.R. Electric Power Authority (PREPA)	348,153	
Christmas bonus reimbursement	28,146	
Total Deferred Inflows of Resources		457,311
Long-term liabilities, including bonds and notes payable, are not due and payable in the current period and, therefore, are not reported in the funds:		
General obligation bonds and notes	(8,825,000)	
Public Act No. 42 January 20, 2001	(1,919,910)	
Public Act No. 146 of October 11, 2001	(414,581)	
Section 515 loan program	(1,666,571)	
Compensated absences	(1,036,063)	
Post-closure care costs	(1,694,062)	
Christmas bonus	(129,995)	
P.R. Department of Labor	(304,058)	
Crim final settlement	(96,006)	
Payable to A.A.A.	(490,000)	
Payable to PREPA	(348,153)	
Total Long-Term Liabilities		(16,924,399)
Total Net Position of Governmental Activities		$ 23,028,715

Reconciliation of the Statement of Revenues,Expenditures, and Changes in Fund Balances (Deficit) of Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2015

Net Change in Fund Balances (Deficit) - Total Governmental Funds	$	(1,254,123)
Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Position, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.		2,563,023
Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Position, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds.		(219,401)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.		457,311
Revenues in the statement of revenues that correspond to the prior year resources are recorded as revenues in the statement of activities.		(909,006)
Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Position, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represented the change in accrued interest from prior year.		-
Construction in progress accounts payable.		-
Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide Statement of Net Position. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long - term liabilities in the Government-Wide Statement of Net Position. This is the amount by which debt proceeds exceed the debt service principal payments.		-
Repayment of long-term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Position:		
General obligation bonds and notes		412,469
Other long-term liabilities		1,072,139
Change in Net Position of Governmental Activities	$	2,122,412

The notes to the financial statements are an integral part of this statement.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arroyo** (the Municipality) is a local municipal government constituted in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act. 81 of August 30, 1991, as amended know as Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

The Commonwealth's Constitution provides for the separation of powers of the executive legislative and judicial branches of the Commonwealth and the municipalities. However, the Municipality's governmental system consists of executive and legislative branches only. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The Municipal Legislature, whose members are also elected every four years exercises the legislative power of the Municipality. The General Justice Court System of the Commonwealth which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes either partial or full responsibility for providing services to its citizens related to public housing, welfare, public safety, health sanitation, education, culture recreation, urban development, economic development and many other fiscal general and administrative services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("USGAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement allows an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality elected to implement the retroactive capitalization of infrastructure assets.

In March 2009, the Municipality adopted the provisions of GASB Statement No.55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB No. 55), and GASB Statement No. 56*, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards (GASB No. 56).*

GASB No. 55 incorporated the hierarchy of USGAAP for state and local governments into the Governmental Accounting Standards Board's (GASB) authoritative literature. The requirements in this Statement codify all USGAAP for state and local governments so that they derive from a single source.

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

GASB No. 56 incorporated into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This Statement addressed three issues not included in the authoritative literature that establishes *accounting* principles-related party transactions, going concern considerations, and subsequent events.

On July 1, 2009, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which modified the interpretations of certain terms within the definition of the special revenue funds and the types of activities the Municipality may choose to report in those funds. GASB No. 54 also clarified the capital projects fund type definition for better alignment with the needs of preparers and users. Definitions of other governmental fund types were also modified for clarity and consistency.

The provisions of the GASB Statement No. 61, *The Financial Reporting Entity*: Omnibus, an amendment of Statements No. 14 and 34, were considered in the evaluation of the potential component units. This statement modifies certain requirements for inclusion of components units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government under certain circumstances.

The GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements (GASB 62), incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance included in FASB pronouncements, which does not conflict with or contradict GASB pronouncements, and eliminates the criteria to apply post November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements.

In current year, the Municipality adopted the provisions of GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and the Net Position establishing a new statement of net position format that reports separately all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). The Statement requires deferred outflows of resources and deferred inflows of resources to be reported separately from assets and liabilities. The financial reporting impact resulting from the implementation of GASB 63 in the Municipality's financial statements was the renaming of "Net Assets" to "Net Position", including changing the name of the financial statement from "Statement of Net Assets" to "Statement of Net Position".

The following is a summary of the significant accounting policies of the Municipality:

A. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality (primary government) and organizations for which the primary government is financially accountable. In addition, the primary government may determine, through exercise of management's professional judgment, that the inclusion of an organization that does not meet the financial accountability criteria is necessary in order to prevent the reporting entity's financial statements from being misleading. Other entities should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. It is a matter of professional judgment to determine whether the nature and the significance of a potential component unit's relationship with the primary government warrant inclusion in the reporting entity. An entity should be considered a component unit if meets any of the following three conditions:

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

1. The primary government appoints a voting majority of the entity's governing body, and either:
   - A financial benefit/ burden exist between the primary government and the entity or
   - The primary government can impose its will on the entity.
2. The entity is fiscally dependent on the primary government and there is a financial benefit/burden between the primary government and the entity.
3. It would be necessary to include the entity as a component unit since the primary government's financial statements would be misleading without it.

In addition, "special criteria" applies when evaluating a legally separate, tax-exempt organization as potential component unit. Specifically, such entities must be treated as component units if they meet all of the following criteria:

1. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
2. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
3. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

Legally separate, tax-exempt organizations that do not meet the above special criteria should still be included as a component unit if the financial statements of the primary government would be misleading without them.

There are two methods of presentation of the component unit in the financial statements: (a) *blending* the financial data of the component units' balances and transactions and (b) *discrete* presentation of the component unit's financial data. When a component unit functions as an integral part of the primary government, its data is *blended* with those of the primary government (*"blended component units"*). That is, the component unit's funds are treated just as though they were funds of the primary government with one exception: the general fund. Component units should be reported as blended if meets any of the following criteria:

1. The component unit's governing body is substantively the same as the governing body of the primary government and there is either:
   - A financial benefit/ burden exist between the primary government and the entity or
   - Management of the primary government has operational responsibility for the primary government.
2. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government.
3. The component unit's debt is expected to be paid by the primary government.

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

Otherwise, the component unit should be presented as discrete. Those component units do not function as an integral part of the primary government and its data is presented discretely (separately) from the data of the primary government (*"discretely component units"*). Legally separate, tax-exempt organizations that meet the special criteria should be included as *discretely component units*.

Based on the above criteria, the Municipality has classify as a component unit, the Housing Project Brisas de Arroyo and is included in the financial statements as blended component unit.

A. Government-wide and fund financial statements

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

1. Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.

2. The government-wide financial statements (i.e. the statement of net position and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

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

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. Pursuant to the provisions set forth by GASB No. 54, the Municipality reported the following governmental funds in the accompanying governmental funds financial statements:

General Fund – is the Municipality main operating fund used to account for and report all financial and reported resources and governmental activities, except for those required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) USGAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund. Its revenues consist mainly of taxes, licenses and permits, intergovernmental, charges for services and other.

Housing Project Brisas de Arroyo Fund – is a major governmental fund used to account for all the transactions of the HUD Housing Project. The primarily objectives of this fund is to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operated under financing from U.S. Department of Agriculture Section 515 Rural Rental Housing Loans Program, and with Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with HUD. For financial reporting purposes, the project is reported as part of the Municipality's operation because its purpose is to provide low-income housing to citizens of the Municipality.

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

Debt Service Fund –is a major governmental fund used to account for and report for the accumulation of financial resources that are restricted for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and (2) certain special long-term obligations for which the Municipality is been accumulating financial resources in advance to pay principal and interest payments maturing in future years.

The other governmental funds of the Municipality account for grants and other resources whose use is restricted for a particular purpose.

The Municipality periodically undertakes a comprehensive evaluation of its fund structure to ensure that it complies with all aspects that are of importance to users of general purpose external financial reports. Consequently, all superfluous funds and some internal funds currently used by the Municipality in the day-to-day accounting procedures have not been reported as individual governmental funds in the accompanying fund financial statements. Accordingly, the accompanying fund financial statements include only the minimum number of funds consistent with legal and operating requirements and, consequently, certain types of similar internal funds have been combined into single funds in the accompanying fund financial statements.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.

5. Required Supplementary Information such as the budgetary comparison schedule-general fund and other types of data required by GASB.

6. Notes to the budgetary comparison schedule-general fund.

7. Supplementary information such as the Schedule of Expenditures of Federal Awards.

8. The Required Supplementary Information consists of the Budgetary Comparison Schedule – General Fund, the Schedule of the Municipality's Proportionate Share of the Net Pension Liability, and the Schedule of Municipality Contributions, as required by GASB.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, 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. Fund types are as follows:

General Fund **-** General Fund is the general operating fund of the Municipality. It is used to account for all financial resources not accounted for and reported in another fund.

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

Capital Projects Fund **-** Capital Projects Funds are used to account for all financial resources restricted, committed or assigned to expenditure for the acquisition or construction of improvement of major capital facilities and other assets.

Special Revenue Fund - Special Revenue Funds are used to account and report the proceeds of specific revenue sources derived from state and federal grants that are restricted or committed to expenditure for specific purposes other than debt service or capital projects. The uses and limitations of each special revenue fund are specified by Municipal ordinances or federal and state statutes.

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

The outstanding balance of certain general long-term obligations for which debt service payments do not involve the advance accumulation of resources (such as certain notes payable, obligations under capital leases, accrued compensated absences, landfill obligation, claims and judgments, net pension liability and other long-term obligations) are only accounted for in the accompanying statement of net position. The debt service payments of such obligations are generally accounted for in the governmental fund which accounted for the financial resources used for the payment of such debts.

D. Measurement focus, basis of accounting and financial presentation

Government-wide financial statements (GWFS) – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest on deposits and investments) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange-like transactions are generally recorded when exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one when there is an identifiable exchange and the values exchanged, though related, may not be quite equal. The accompanying basic financial statements include exchange-like transactions such as license fees, fines, penalties, forfeitures, and permits, charges for services, and most miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received.

The Municipality groups its non-exchange transactions into the following four (4) classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions. In the case of derived tax revenue transactions, which result from assessments that the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred (such as municipal license tax). In the case of imposed non-exchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on non-governmental entities, including individuals, other than assessments on exchange transaction, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license taxes are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used for the first fiscal year that the use of the resources is permitted.

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

For government-mandated non-exchange transactions (such as intergovernmental grants and contributions), receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Therefore, revenue is generally recognized as qualifying reimbursable expenditures are incurred.

For voluntary non-exchange transactions (such as donations and certain grants and entitlements) receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above.

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2015. Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

According to GASB No. 34, all general capital assets and the unmatured long-term liabilities are recorded only in the accompanying statement of net position. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus used in the preparation of the GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

Government Fund Financial Statements (GFFS) – The accompanying GFFS are reported using the current financial resources measurements focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal licenses taxes, construction excise taxes, sales and use taxes, interests on deposits, intergovernmental grants and contributions and certain charges for services) to be available if collected within sixty (60) days after June 30, 2015. At June 30, 2015, all revenues sources met this availability criterion.

Property taxes are all considered susceptible to accrual if commonly collected within sixty (60) days following the end of the fiscal period, unless unusual circumstances justify a greater period.

Other revenue sources considered susceptible to accrual include municipal license taxes, sales and use taxes, construction excise taxes, intergovernmental grants and contributions, interests on deposits and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS.

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

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange, exchange-like transactions are also generally recorded when the exchange takes place while all revenues, expenses, gains, losses, and assets resulting from non-exchange transactions are recorded when an enforceable legal claim arises or when all eligibility requirements imposed by the provider have been met, applicable. Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2015.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. The accompanying Balance Sheet – Governmental Funds generally reflects only assets that will be converted into cash to satisfy current liabilities.

Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying Balance Sheet – Governmental Funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying Balance Sheet – Governmental Funds.

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying Statement of Activities, but are not recorded in the accompanying GFFS.

E. Assets, liabilities and net position

1. **Cash, cash equivalents, and cash with fiscal agent**- The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

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

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

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

Advances between funds, as reported in the fund financial statements, if any, are offset by a fund balance assignment account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represent the balance due from the Municipal Revenue Collection Center (CRIM) resulting from the final liquidations of advances made by CRIM to the Municipality corresponding to collections from property taxes and legislative appropriations from the Commonwealth of Puerto Rico plus final liquidation of contributions in lieu of taxes payable by the Puerto Rico Electric Power Authority (PREPA) to the Municipality. During the last years, the Puerto Rico Electric Power Authority has not been financially able to afford the cost of the Contribution in Lieu of Taxes as required by Section 22(b) of Act Number 83-1941, as amended. For those years, the Authority has recognized a partial credit for each year and has amortized the remaining amount owed during the three subsequent fiscal years. As of June 30, 2015, the Contribution in Lieu of Taxes corresponding to the Municipality of Arroyo amounted to $348,153. Management anticipates that due to the serious financial limitations being encountered by PREPA, the reaming non-credited balance of such amount will be amortized during the fiscal years 2016 and 2017. Intergovernmental Receivables in the debt service fund represent the amounts due from the CRIM resulting from the excess of current year property tax collections over current year advances. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

During the beginning of fiscal year 2008-2009, the Municipality resolved the contract signed with the Secretary of the Treasury to collect and distribute the revenues produced by the sales and use tax. As part of the new organizational chart implemented for the Finance Directorate, a new unit was created under such directorate which has been responsible to manage this function at the Municipality's level. Such decision has been beneficial for the Municipality in its search for additional increases in current revenues derived from such tax.

3. **Inventories**- Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net position.

4. **Capital assets**- Capital assets include land and land improvements, buildings, structures and building improvements, machinery and equipment (including equipment held under capital leases), furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. The Municipality defines capital assets as assets with an initial, individual cost of more than $500 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

   The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

   Major outlays for capital assets and improvements are capitalized as projects are constructed.

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

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

Description	Useful Life
Land Improvements	20 years
Buildings, structures and building improvements	30 to 50 years
Infrastructure	20 to 50 years
Motor Vehicles	5 years
Furniture and fixtures	5 to 20 years
Machinery and equipment	5 to 20 years
Equipment held under capital leases	3 to 5 years

5. Unearned revenues- In the GFFS, unearned revenues arises when:

a. The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for unearned revenue is removed and revenue is recognized.

E. Deferred outflows/inflows of resources

In addition to assets, the Statement of Net Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/ expenditure) until then.

In addition to liabilities, the Statement of Financial Position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

The government has three items that qualify for reporting in this category:

1. **Government-mandated or voluntary non-exchange transactions received before the time requirements have been met –** Federal and state grants received before the beginning of the fiscal year to which they pertain are recognized as deferred inflows of resources on both the Balance Sheet of the governmental funds and in the government-wide Statement of Net Position. The amounts deferred would be recognized as an inflow of resources (revenue) in the period in which the time requirements are fulfilled.

2. **Unavailable revenue reported under the modified-basis of accounting –** Amounts collected or to be collected after the availability period are recognized as *unavailable revenue* in the governmental funds Balance Sheet. The amounts are deferred and recognized as an inflow of resources (revenue) in the period that the amounts become available. Since this deferred inflow of resources is the result of the modified-accrual basis of accounting, it is only reported in the governmental fund financial statements.

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

3. **Deferred outflows/inflows of resources related to pensions –** Amounts reported for changes in the calculation of the net pension liability that result from: a) differences between expected and actual experience; b) changes of assumptions; c) net difference between projected and actual earnings on pension plan investments; d) changes in proportion and difference between Municipality's contributions and proportionate share of contributions; and e) Municipality's contributions subsequent to the measurement date.

6. **Long-term obligations-** The liabilities reported in the government-wide financial statements include general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

   In the fund financial statements, governmental fund types recognize bond issuances 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

7. **Compensated absences**- Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

   Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when the employee meets such criteria.

8. **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 when the liability is incurred due.

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

9. Fund Balances – On July 1, 2009, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB No. 54, the accompanying GFFS report fund balance amounts that are considered restricted, committed, assigned and unassigned, based on the relative strength of the constrains that control how specific amounts can be spent, as described as follows:

a. ***Restricted*** – Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). These, restrictions may be changed or lifted only with the consent of resource providers.

b. ***Committed*** – Represent resources used for specific purposes, imposed by formal action of the Municipality's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.

c. ***Assigned*** – Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.

d. ***Unassigned*** – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Negative fund balance amounts are assigned amounts reduced to the amount that will raise the fund balance to zero. Consequently, negative residual amounts in restricted, committed and assigned fund balance classifications have been reclassified to unassigned fund balances.

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balances amounts as of for the fiscal year ended June 30, 2015.

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

In situations when expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the Municipality generally spends restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources.

10. Net position - Net position has been reported pursuant to the provisions of GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. Net Position represents the difference between all assets plus deferred outflows of resources and all liabilities plus deferred inflows of resources. The Net Position consists of net resources restricted by external parties (such as debt covenants, creditors, grantors, contributions, laws or regulations of other governments, ect.) or net position for which constraints are imposed by the constitutional provisions or enabling legislation.

Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

A legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. The Municipality periodically reevaluates the legal enforceability of an enabling legislation to determine if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration.

The classification of restricted net position identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designation of resources, including earmarking, are not reported as restricted net position. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

In the government-wide statements, net position is segregated into three categories:

a. ***Net investment in capital assets***: Represents the component of the net position that consist of capital asset balances, net of accumulated depreciation, and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds).

b. ***Restricted net position***: Represents the component of the net position that is subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

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

c. ***Unrestricted net position***: Represents the component of the net position that does not meet the definition of net investment in capital assets or restricted. Unrestricted assets are often designated to indicate that Management does not consider them to be available for general operations. These types of constraints are internal and Management can remove or modify them. Designations are not reported on the face of the statement of net position.

11. Accounting for Pension Costs

The Municipality has not adopted the provisions of GASBS No. 68, *Accounting and Reporting for Pensions – an amendment of GASB Statement No. 27*, and GASBS No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date,* which amended GASBS No.68.

The Municipality accounts for pension costs from the standpoint of a participant in a multi-employer cost-sharing plan. Accordingly, the net pension liability, pension expense and deferred outflows/inflows of resources recognized in the accompanying basic financial statements are equal to the Municipality's proportionate shares of the collective net pension liability, pension expense and collective deferred outflows/inflows of resources reported for the pension plans' trust by the plan's administrator as of the measurement date. In addition, if the Municipality's annual contributions are less than the statutorily required amounts, a liability is recorded for any unpaid balances.

For the purpose of applying the requirements of GASBS Nos. 68 and 71, the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a multi-employer hybrid defined contribution plan in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of this retirement system since the majority of the participants in the aforementioned pension trust fund are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement system are part of the Commonwealth's financial reporting entity.

For purposes of measuring the net pension liability, deferred outflows/inflows of resources related to pensions and pension expense, information about the fiduciary net position of the ESR plan and additions to/reductions from the ESR plan's fiduciary net position have been determined on the same basis as they are reported by the ESR. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

12. Interfund and intra-entity transactions- The Municipality has the following types of transactions among funds:

a. Operating Transfers- Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

b. Intra-Entity Transactions- Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

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

13. **Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico. Under Act No. 63 of June 21, 2010, the Legislative Assembly of the Commonwealth of Puerto Rico, authorized the municipalities to procure and manage at their own discretion all insurance policies, including those related to health plans being provided to the municipal employees. The Municipality obtains medical insurance from a health insurance company for its employees. Different health coverage and premium options are negotiated each year by the Municipality. Premiums are paid on a monthly basis directly to the insurance company.

    Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2015 amounted to $234,363. The current insurance policies have not been cancelled or terminated. The CRIM also deducted $259,451 for workers compensation insurance covering all municipal employees.

14. **Use of Estimates-** The preparation of financial statements in conformity with USGAAP requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual amounts could differ from those estimates.

2. CASH AND CASH EQUIVALENTS

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and Government Development Bank for Puerto Rico (GDB). Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

Credit risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as it's custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2015.

2. CASH AND CASH EQUIVALENTS (CONTINUED)

Interest rate risk – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2015, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2015, the Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2015, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

Custodial credit risk – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of $250,000 per depositor

In addition, public funds deposited in commercial banks are fully collateralized for the amounts deposit in excess of the federal depository insurance. All securities pledged as collateral are held, in the Municipality's name, by the Commonwealth's Secretary of Treasury Deposits with GDB are unassured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2015. Therefore, the Municipality's management has concluded that at June 30, 2015, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

Foreign exchange risk – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, Management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2015.

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

Deposits - The Municipality's bank balances in commercial banks of approximately $7,179 and $1,586,087 in the Housing Project Brisas de Arroyo Fund and the Other Governmental Funds, respectively, were fully collateralized at June 30, 2015. In addition, the Housing Project Fund maintained $678,306 of restricted cash. The General Fund presents a bank overdraft of $646,111, at June 30, 2015.

The deposits at GDB of approximately $376,587 that are restricted for other purposes reported in the General Fund, the $1,139,948 in the Debt Service Fund and $1,027,346 in the Other Governmental Funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES

A. ***Property taxes -*** Property taxes receivable recorded in the General Fund and the Debt Service Fund amounted to $81,012 and $49,410, respectively.

B. ***Municipal License Tax-*** the Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of $3,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2015, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2015, net of allowance for uncollectible accounts. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as unearned revenues.

C. ***Municipal sales and use tax***

On July 4, 2006, the Commonwealth Legislature approved Act No. 117 ("Act 117") which amends the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a sale and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sale and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax.

On July 29, 2007, the Commonwealth Legislature approved Act No. 80 (Act 80), which amends Act No. 117 of July 4, 2006 to impose to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007, 1% of the 1.5% is collected by the Municipalities and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of Treasury (PRDT).

The amount collected by the PRDT, (.5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico (GDB), subject to restrictions imposed and distributed as follows:

- .2% of the .5% will be deposited in a Municipal Development Fund to be distributed among all the municipalities in accordance with a formula created by the Act,
- .2% of the .5% will be deposited in a Municipal Redemption Fund to finance loans to Municipalities and,
- .1% of the .5% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES (CONTINUED)

Effective January 1, 2011, the Commonwealth of Puerto Rico adopted a new Internal Revenue Code (2011 PR Code). Subtitle D (Sections 4010 to 4070) of the 2011 PR Code incorporates the dispositions applicable to the sales and use tax. As stated by Section 4050, the Municipalities may use the sales and use tax proceeds to finance solid waste, recycling, capital projects, health and public safety programs as well as any other activity that promotes sound public administration.

On June 30, 2013, the Commonwealth approved Act No. 40 which, among other things, reduces the municipal sales and use tax from 1.5% to 1% and increases the Commonwealth's sales and use tax from 5.5% to 6% effective December 1, 2013. This Act was subsequently amended to change this effective date from December 1, 2013 to February 1, 2014.

In order to address the fiscal and credit crisis of the Commonwealth of Puerto Rico, the GDB liquidity and the difficult fiscal situation of the municipalities of Puerto Rico, on January 24, 2014, the

Commonwealth approved Act No. 18 and 19. Those Acts provide for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long-term debt issuances.

Act No. 18 creates a special fund called the Municipal Administration Fund (FAM), under the custody of the Government Development Bank of Puerto Rico (GDB), which permits the municipalities to guarantee and pay long term debt and provide funds for its general operations. In addition, this Act improves the financing capacity of the Puerto Rico Sales Tax Financing Corporation (COFINA), a Commonwealth fund administered by GDB and the P.R. Secretary of Treasury. The Act also includes special provisions for municipalities that do not want to be covered by the Act.

After July 1, 2014, the 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds, the Commonwealth will deposit .5% in the FAM. Distribution to the municipalities will depend on whether the municipalities signed an agreement to be covered or not covered by the Act's provisions. The Municipality signed the agreement to be covered.

For municipalities covered by the agreement, the .5% will be distributed as follows:

- .2% will be deposited in the Municipal Development Fund to be distributed to the municipalities,
- .2% will be deposited in a Municipal Redemption Fund to then be deposited in the municipalities general fund (the municipalities have the option to maintain funds in the Municipal Redemption Fund or to transfer funds from the Municipal Development Fund to increase its debt margin and issue loans to be obtained from financial institutions)
- .1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES (CONTINUED)

For municipalities not covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the Municipal Development Fund. Section 4 of the Act requires amounts deposited in the Municipal Development Fund of municipalities not covered by the Act to be redistributed to the municipalities covered by the Act,

- .2% will be deposited in a Municipal Redemption Fund to guarantee and repay long-term debt through any financial institution (each semester the municipalities may transfer to their general fund the funds in excess of debt service requirements),

- .1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

Act No. 19 creates the Municipal Finance Corporation (COFIM), a public corporation and a component unit of the Governmental Development Bank of Puerto Rico (GDB) which may issue, pay or refinance long-term debt of municipalities. Principal and interest of these bonds and loans will be guaranteed with the municipal sales and use tax of 1%. The Act also includes special provisions for municipalities that do not want to be covered by the Act.

After July 1, 2014, the 1% corresponding to the municipalities' sales and use tax will be deposited in COFIM. From these funds COFIM will deposit to the COFIM's sinking fund the greater of: .3% of the 1% municipal sales and use tax or an Annual Rental Fee (RFA). The RFA for fiscal year 2014-2015 will be $65,541,281 and thereafter will be 1.5% of the RFA of the preceding fiscal period. The excess of the required deposit to the COFIM's sinking fund (.7% of the 1% of the municipal sales and use tax) will be transferred to the general fund of municipalities covered by the agreement or to the Municipal Redemption Fund as decided by the municipality. Before the transfer of the .7% to the municipalities covered by the Act, COFIM will transfer the 1% municipal sales and use tax to the municipalities not covered by the Act. These municipalities cannot obtain loans guaranteed by COFIM's sinking fund.

If at any moment the required deposits to the COFIM's sinking fund were not sufficient to pay the principal and interest of any outstanding obligation, the deficiency will be covered by appropriations of the Commonwealth's general fund budget.

Individuals, organizations and entities subject to the collection of the municipal sales and use tax must file a tax return to COFIM. The tax is due on or before the 20th day of each month based on the tax collected in the preceding month. COFIM has provided retailers three alternatives for the filling of the monthly return: 1) electronic filling through COFIM's internet portal; 2) in the bank branches of the financial institution designated by COFIM to be its intermediary, the Popular Bank of Puerto Rico; and 3) in the collections offices of the municipalities that have been certified as collection agents of COFIM.

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES (CONTINUED)

COFIM established a system of monthly advances for the transfers of the .2% destined for the Municipal Development Fund (FDM), the .2% related to the Municipal Redemption Fund (FRM) and the 1% of municipal sales and use tax. Each month, the GDB will make the FDM, FRM and 1% sales and use tax transfers based on the amounts collected that same month in the preceding fiscal year (2013-2014). At the end of the year, a settlement will be made comparing the actual collections of the FDM, FRM and the 1% sales and use tax with the monthly advances made to each municipality. If actual collections exceed the total advances received, an account receivable from GDB will be recognized; if actual collections are less than the total advances, a payable to the GDB will be recognized and amortized through withholdings from future advances.

D. ***Due from Commonwealth Government*** **-** In the General Fund, Intergovernmental receivable represents expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivable:

Governmental Entity	Amount
P.R. Treasury Department (Christmas bonus reimbursements)	$ 28,146
P.R. Office of Management and Budget (Special Law reimbursements)	115,240
P.R. Electric Power Authority	348,153
Total	**$ 491,539**

Governmental Entity	Amount
P.R. Department of Labor- Law 52	$ 95,000
P.R. Treasury Department (state assignments reimbursements)	159,887
Total	**$ 254,887**

E. ***Due from Federal Government*** **-** Federal Government receivables represents expenditures incurred not yet reimbursed by the Federal Government or the pass-through grantors. Following is a detail of amounts included in this item:

Federal Program Description	Amount
Community Development Block Grant – State's Program	$ 467,950
Child Care Development Block Grant	241,645
Community Service Block Grant	34,712
Homeland Security Grant	88,001
Others	13,571
Total	**$ 845,879**

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES (CONTINUED)

F. Miscellaneous receivables in the Brisas de Arroyo Fund amounting $10,362, represent rent invoices billed and not received at June 30, 2015.

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2015, and interfund transfers during the fiscal year ended at June 30, 2015, are summarized as follows:

a. Due from/to other funds:

Receivable Fund	Payable Fund	Purpose	Amount
General Fund	Other Governmental Funds	Reimbursable expenditures	$1,162,967
Other Governmental Funds	General Fund	Reimbursable expenditures	471,739
Total			**$1,634,706**

b. Transfer in/out to other funds:

Transfer out	Transfer in	Purpose	Amount
General Fund	Debt Service Fund	Debt retirement	$ 31,950
General Fund	Other Governmental Funds	Transfer of funds or operational activities	146,224
Debt Service Fund	Other Governmental Funds	Transfer of the excess of the redemption funds	877,972
Other Governmental Funds	General Fund	Transfer of funds or operational activities	463,968
Total			**$ 1,520,114**

5. CAPITAL ASSETS

Capital assets, those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of $500 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2015, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

Governmental Activities:	Balance July 1, 2014	Additions	Retirements	Balance June 30, 2015
Capital assets, not being depreciated:				
Land	$ 9,705,674	$ 30,000	$ -	$ 9,735,674
Construction in progress	1,707,339	1,860,836	(123,382)	3,444,793
Work of art	3,410	-	-	3,410
Land- Housing Project	595,000	-	-	595,000
Total capital assets not being depreciated	12,011,423	1,890,836	(123,382)	13,778,877
Capital assets, being depreciated:				
Buildings structures and building improvements	24,392,266	141,559	-	24,533,825
Infrastructure	10,852,226	450,122	123,382	11,425,730
Vehicles, machinery and equipment	2,467,584	72,520	-	2,540,104
Furniture and fixtures	1,464,687	-	-	1,464,687
Building and equipment- Housing Project	3,779,493	7,986	-	3,787,479
Total capital assets being depreciated	42,956,256	672,187	123,382	43,751,825
Less accumulated depreciation for:				
Buildings structures and building improvements	(9,579,944)	(5,267)	-	(9,585,211)
Infrastructure	(3,853,853)	(75,973)	-	(3,929,826)
Vehicles, machinery and equipment	(2,277,013)	(34,564)	-	(2,311,577)
Furniture and fixtures	(1,316,435)	-	-	(1,316,435)
Building and equipment- Housing Project	(3,237,741)	(103,597)	-	(3,341,338)
Total accumulated depreciation	(20,264,986)	(219,401)	-	(20,484,387)
Total capital assets being depreciated, net	22,691,270	452,786	123,382	23,267,438
Governmental activities capital assets, net	**$ 34,702,693**	**$ 2,343,622**	**$ -**	**$ 37,046,315**

Depreciation expense was charged to functions/programs of the Municipality as follows:

Governmental activities:	Amount
General government	$ 1,321
Urban development	89,212
Public safety	6,107
Culture & recreation	7,159
Human services & welfare	115,602
Total depreciation expense-governmental activities	**$ 219,401**

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2015 are summarized as follows:

Description	General Fund	Brisas de Arroyo Fund	Other Governmental Funds	Total
Accounts payable	$ 333,930	$ 60,779	$ 764,464	$ 1,159,173
Accrued liabilities	190,153	-	-	190,153
Total	$ 524,083	$ 60,779	$ 764,464	$ 1,349,326

7. DUE TO OTHER GOVERNMENTAL ENTITIES

The amounts due to other governmental entities in the General Fund include the following:

Governmental Entity	Amount
P.R. Aqueduct and Sewer Authority	$ 63,184
Retirement System Administration	77,193
Retirement System Administration (Special Laws)	115,240
P.R. Department of Labor	5,235
General Services Administration	12,566
Total	**$ 273,418**

8. UNEARNED REVENUES

A. Municipal License Tax- The unearned revenues of $749,136 in the general fund relates to municipal license tax collected in fiscal year 2014-15 that will be earned in fiscal year 2015-16.

B. Federal Government- The unearned revenues presented in the other governmental funds represent the portion of federal grants received for which qualifying expenditures have not been incurred. Unearned revenues from the federal government are as follows:

Program Description	Amount
Disaster Grants – Public Assistance	$ 211,586
Others	17
Total	**$ 211,603**

8. DEFERRED INFLOWS OF RESOURCES – GOVERNMENTAL FUNDS

As required by current standards, revenues and other governmental fund financial resources should be recognized in the accounting period in which they become both measurable and available. When an asset is recorded in governmental funds' financial statements but the revenue is not available, the Municipality should report a deferred inflow of resources until such time as the revenue becomes available. A detail of these balances follows:

	Inter-governmental
Major fund - General fund:	
P.R. Department of Treasury – Christmas bonus reimbursement	$ 28,146
Municipal Revenues Collection Center (CRIM)	81,012
P.R. Electric Power Authority (PREPA)	348,153
	$ 457,311

9. PROPERTY TAXES

The personal property tax is self-assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center ("CRIM"), a governmental entity created by the government of Puerto Rico as part of the Municipal Legislation approved in August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections.

The CRIM is required by law to prepare a liquidation statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end, subject to the verification by its Independent Auditors. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. For the fiscal year ended June 30, 2015, the CRIM issued the final liquidation reporting that collections exceeded advances by $81,012.

9. PROPERTY TAXES (CONTINUED)

On January 26, 2000, Public Law No. 42 was enacted, which authorized the CRIM to obtain a loan up to $200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years. The Statement of Net Position includes an outstanding debt balance of $1,919,910 at June 30, 2015 related with Law No. 42.

Also, on October 11, 2002, Public Law No. 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law No. 42 enacted on January 26, 2000.

On June 26, 1997, Public Law No. 21 was enacted, authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible.

In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities through a 30-year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law. During the first five years of the note, commenced in July 1, 2003, the Municipality shall pay only interest. At the end of the first five years of the note, the repayment terms and conditions of the note shall be renegotiated to allow the Municipality to pay the outstanding balance of the note in equal installments of principal plus interest, through maturity. The Statement of Net Position includes an outstanding debt balance of $414,581 related to Law No. 146.

9. PROPERTY TAXES (CONTINUED)

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first $15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than $3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury Department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to $50,000 of the assessed value to retailers having annual net sales of less than $150,000.

10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2015, was as follows:

Description	Beginning Balance, as restated	Borrowings or Additions	Payments or Deductions	Ending Balance	Due Within One Year
Bonds payable	$ 9,605,000	$ -	$ (455,000)	$ 9,150,000	$ 325,000
Public Act No. 42 January 20, 2001	1,979,494	-	(59,584)	1,919,910	63,327
Public Act No. 146 of October 11, 2001	438,968	-	(24,387)	414,581	24,387
Claims and judgments	15,139	-	(15,139)	-	
Section 515 Loan Program	1,724,040	-	(57,469)	1,666,571	62,366
Landfill closure and post-closure care costs	1,694,062	-		1,694,062	
System Retirement Administration- Repayment Plan	49,603		(49,603)	-	
Christmas Bonus	126,288	129,995	(126,288)	129,995	129,995
Compensated absences	1,486,612	-	(450,549)	1,036,063	175,000
P.R. Department of Labor- Repayment Plan	448,069	-	(144,011)	304,058	102,134
CRIM- Final Settlement 2013-2014	96,006	-		96,006	96,006
P.R. Electric Power Authority	850,349	-	(502,196)	348,153	348,153
A.A.A.- Repayment Plan	320,377	257,135	(87,512)	490,000	120,000
Total	**$ 18,834,007**	**$ 387,130**	**$ (1,971,738)**	**$ 17,249,399**	**$ 1,446,368**

A. Legal debt margin- The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

10. LONG-TERM LIABILITIES (CONTINUED)

B. Bonds payable- The Municipality issues general obligation, special obligation and public improvement bonds to finance the acquisition, construction and improvement of capital assets, as well as to finance certain operating needs, including the payment to suppliers in certain circumstances.

The laws and regulations of the Commonwealth provide that the Municipality's public debt will constitute a first claim on the available revenue of the Municipality. Public debt is composed of bonds and notes payable. The good faith credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of bonds.

As describe in **Note 9** the Municipality levies an annual additional special tax of 4.00 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's Debt Service Fund.

For financial reporting purposes the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2015:

Description	Balance at June 30, 2015
2002 General bond obligation for construction and improvement of infrastructure assets with an original amount $1,410,000 due in installments of $20,000 to $125,000 through July 1, 2026, with interest of 5.0%	$ 995,000
2002 General obligation bond for operational purposes with an original amount of $940,000 due in installments of $10,000 to $80,000 through July 1, 2026, with interest of 7.5%	660,000
2007 General obligation bond for construction and improvements of infrastructure with an original amount of $1,250,000 due in installments of $20,000 to $105,000 through July 1, 2031, with interest of 7.0%	1,045,000
2010 General obligation bond for construction and improvements of infrastructure with an original amount of $1,355,00 due in installments of $55,000 to $140,000 through July 1, 2024, with interest of 7.0%	1,045,000
2009 General obligation bond for construction and improvement of infrastructure assets with an original amount of $4,640,000 due in installments of $70,000 to $385,000, through July 1, 2033, with interest of 7.5%	4,140,000
2011 General obligation bond for operational purposes with an original amount $1,910,000 due in installments of $15,000 to $110,000 through July 1, 2035, with interest ranging from 6.0% to 7.5%	1,265,000
Total general obligation bonds	**$ 9,150,000**

10. LONG-TERM LIABILITIES (CONTINUED)

These bonds and notes are payable from the special ad valorem property tax of 4.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. The before detailed bond is payable with General Fund resources. The bonds and notes amounting $4,640,000 and $1,315,000 are payable with the revenues generated from the collection of the .2% of the municipal sales and use tax imposed by the Municipality and collected by the Commonwealth of Puerto Rico Treasury Department.

Annual debt service requirements to maturity for bonds payable are as follows:

Year Ending June 30,	Principal	Interest
2016	$ 325,000	$ 263,570
2017	355,000	570,137
2018	375,000	547,675
2019	410,000	523,575
2020	435,000	497,650
2021-2025	2,735,000	2,027,300
2026-2030	2,360,000	1,198,700
2031-2035	2,045,000	362,765
2036-2040	110,000	4,125
Total	**$ 9,150,000**	**$ 5,995,497**

C. **Property Taxes Debts (Law No. 146 and Law No. 42)-** These amounts represents the balance owed to the Municipal Revenue Collection Center ("CRIM") at June 30, 2015 as described in Note 9.

D. **Compensated absences-** The government-wide statement of net position includes approximately $1,036,063 of accrued sick leave benefits and accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

E. **Landfill closure and post-closure care costs -** State and federal laws and regulations require the Municipality to place a final cover on its landfill site, when it stopped accepting waste, and perform certain maintenance and monitoring functions at the site for 30 years after closure. GASB statement No. 18 of "Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs," requires the Municipality to perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. The Municipality has not performed such a study but has recognized $1,694,062 as an estimated current cost for landfill post-closure cares costs as of June 30, 2015. Actual costs may be different once a study has been made as per the required regulations and due to inflation, changes in technology, or changes in laws and regulations. The balance of post-closure costs is reported in the government-wide statement of net position

F. **Department of Labor repayment plans –** These amounts represent the balance owed to the Department of Labor related with unemployment compensation.

10. LONG-TERM LIABILITIES (CONTINUED)

G. **Claims and judgments –** Represents the estimated loss of legal cases to be paid subsequent to June 30, 2015 The awarded amount, if any, will be paid with unrestricted funds.

H. **A.A.A. repayment plan –** These amounts represent the balance owed to the Agency related with services of water and sewage for the Municipal facilities.

I. **Section 515 Rural Rental Housing Loan Program –** Two mortgages notes, collateralized with land and buildings of Housing Project Brisas de Arroyo, payable to Rural Development of the U.S. Department of Agriculture, in monthly installments of $12,892 and $1,994, including interest at an annual rate of 8% (reduced to 7%) and 10% (reduced to 9%) through December 2029.

J. **CRIM- Final Settlement 2013-2014 –** For the fiscal year ended, June 30, 2014 the CRIM notify to the Municipality that the final settlement of property tax advances versus actual collections through fiscal year 2014 result in an overpayment to the Municipality of $96,006.

K. **Christmas Bonus –** represents the accrued portion corresponding to the fiscal year 2015 of the Christmas bonus to be paid in December 2015. The outstanding amount is $129,995.

L. **P.R. Electric Power Authority –** As required by Act No. 83 of May 2, 1941, the Puerto Rico Electric Power Authority ("PREPA") should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax ("CELI") based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. However, PREPA has not yet issued the final liquidation for the fiscal year ended on June 30, 20014. Therefore, as of June 30, 2015, the outstanding amount of $348,153 only includes the unamortized balance from fiscal year 2013, and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:

June 30	Principal
2016	348,153
Total	**$ 348,153**

11. PENSION PLAN

General Information about the Pension Plan

As of June 30, 2015, regular employees of the Municipality contribute to a cost-sharing multiple employer hybrid defined benefit and defined contribution retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full-time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation. The pension plan operates under Act No. 447 of May 15, 1951, as amended, Act No. 305 of September 24, 1999 (System 2000 Reform) and Act No. 3 of April 4, 2013.

Under Act 447, retirement benefits were determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation was computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member was eligible, was limited to a minimum of $200 per month and a maximum of 75% of the average compensation. For active participants of the contributory defined benefit programs under Act No. 447, all retirement benefits accrued through June 30, 2013 were frozen. Thereafter, all future benefits will accrue under the hybrid pension plan established by Act No. 3. Participants will receive a pension at retirement age equivalent to what they had accrued under Act 447 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.

Participants under the defined contribution plan established by Reform System 2000 will receive a lifetime annuity calculated at retirement based on a factor that will incorporate the individual's life expectancy and a rate of return. New participants under the hybrid plan established by Act No. 3 will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees' contributions plus a return on investment). The minimum monthly pension for current retirees is $500.

Disability benefits previously provided by Act No. 447 and Reform System 2000 were eliminated by Act No. 3 and substituted for a mandatory disability insurance policy. Beginning July 1, 2013, each employee must contribute to this insurance plan .25% of his or her monthly salary, up to a monthly maximum of $5,000. Therefore, the maximum monthly employee contribution will be $12.50 ($5,000 x .25%).

Beginning July 1, 2013, all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016, an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. For the fiscal year ended June 30, 2015, the employer contribution rate was 13.275% and the total required annual contribution amounted to $456,103.51

As required by Act 32 of June 25, 2015, the Additional Uniform Contribution (AUC) was established for the purpose of solving the cash flow deficit of the System. For each fiscal year, beginning on July 1, 2013, the ERS will: 1) determine the portion of the AUC attributable to each participating employer based on the percentage each employer's contributions represent of the total employer contributions established for that fiscal year; and 2) send to the director of the P.R. Office of Management and Budget (OMB) and to each public corporation and municipality whose employees are covered by this Act, a certification of the AUC owed by each employer.

11. PENSION PLAN (CONTINUED)

Pension Liabilities, Pension Expense, and Deferred Outflows/Inflows of Resources Related to Pensions

As per the requirements of the GASB Statements No. 67 and 68, ESR is required, as the pension plan's administrator, to provide to each of its participating employers audited actuarial and financial information used in the calculation of their proportionate share of the plan's net pension liability, pension expense and deferred outflows/inflows of resources related to pensions as of the measurement date. For the fiscal year ended June 30, 2015, the measurement date is June 30, 2014. In addition, the ESR has to provide all the required actuarial and historical data to be reported in the notes to the financial statements of the Municipality and as Required Supplementary Information (RSI).

However, as indicated in the Basis for Adverse Opinion section of the independent auditors' report, the ESR has not provided to the Municipality the audited actuarial and financial information necessary for the proper recognition and reporting of its net pension liability as of June 30, 2015. As a result, management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68. The ESR has informed its participating employers that the audited actuarial and financial data will be available in a future date during the calendar year 2016. The effects of this departure from U.S. generally accepted accounting principles in the assets, liabilities, deferred outflows/inflows of resources and net position of the Municipality's governmental activities cannot be determined at this time.

12. POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in note 15, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas bonuses and death benefits. However, beginning July 1, 2013, Act No. 3 of 2013 eliminated all Special Law benefits to future retirees.

13. RISK MANAGEMENT

The Property Division, attached to the Municipality, is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three (3) fiscal years.

14. COMMITMENTS AND CONTINGENCIES

The Municipality has reported outstanding encumbrances amounting to $113,239 in the General Fund at June 30, 2015. The Municipality intends to honor these encumbrances which will continue to be liquidate under the current year's budget during a lapse period that extends into the fiscal year.

15. FUND BALANCE (DEFICIT)

As of June 30, 2015, fund balance (deficit) is comprised of the following:

	General Fund	Brisas de Arroyo Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Restricted					
General government	$ 23,614	$ -	$ -	$ -	$ 23,614
Public safety				88,847	88,847
Public works				58,166	58,166
Culture and recreation				11,845	11,845
Health & welfare		662,100		317,301	979,401
Urban development				1,566,243	1,566,243
Debt service			730,112		730,112
Committed					
Urban development	352,972	-	-	-	352,972
Unassigned	(1,361,712)	-	-	-	(1,361,712)
Total fund balances (deficit)	**$ (985,126)**	**$ 662,100**	**$ 730,112**	**$ 2,042,402**	**$ 2,449,488**

16. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The GASB has issued the following statements that have effective dates after June 30, 2015:

1. **GASB Statement No. 72 "Fair Value Measurement and Application."** The provisions of this Statement are effective for fiscal years beginning after June 15, 2015 (fiscal year ended June 30, 2016).

2. **GASB Statement No. 73 "Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68."** The provisions of this Statement are effective for fiscal years beginning after June 15, 2015 (fiscal year ended June 30, 2016), except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016 (fiscal year ended June 30, 2017).

3. **GASB Statement No. 74 "Financial Reporting for Postemployment Benefit Plans Other Than Pensions."** The provisions of this Statement are effective for fiscal years beginning after June 15, 2016 (fiscal year ended June 30, 2017).

4. **GASB Statement No. 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions."** The provisions of this Statement are effective for fiscal years beginning after June 15, 2017 (fiscal year ended June 30, 2018).

5. **GASB Statement No. 76 "The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments."** The provisions of this Statement are effective for fiscal years beginning after June 15, 2015 (fiscal year ended June 30, 2016).

6. **GASB Statement No. 77 "Tax Abatement Disclosures."** The provisions of this Statement are effective for fiscal years beginning after December 15, 2015 (fiscal year ended June 30, 2017).

The impact of these Statements on the Municipality's basic financial statements has not yet determined by the Municipality's management.

17. PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

Description	General Fund
Fund balance (deficit), beginning	$ (1,330,137)
Reclassification of A.A.A. debt	320,377
Fund balance (deficit), beginning, as restated	$ (1,009,760)

18. SUBSEQUENT EVENTS

Puerto Rico Fiscal and Economic Growth Plan

On September 9, 2015, the Working Group for the Fiscal and Economic Recovery of Puerto Rico established by the Governor Alejandro García Padilla by executive order EO 2015-022 submitted the Fiscal and Economic Growth Plan (FEGP), setting forth economic development, structural, fiscal and institutional reform measures intended to meaningfully reduce the Commonwealth's projected financing gaps. In order to ensure compliance with the FEGP measures, the Working group proposes the implementation of a control board and new budgetary regulations, pursuant to proposed legislations known as the Fiscal Responsibility and Economic Revitalization Act (FRERA). The reform measures proposed by the FEGP, including the creation of the control board, have been submitted to the Commonwealth Legislature for review and final approval.

New Guidelines for the Calculation of the Contribution In Lieu of Taxes ("CELI")

On October 16, 2015, the Puerto Rico Commission of Energy ("CEPR") approved the new guidelines for the energetic subsidy (contribution) received by the 78 municipalities of the Commonwealth from the Puerto Rico Electric Power Authority (PREPA) in lieu of the payment of municipal license taxes ("CELI"). These guidelines limit to the subsidy to be received by the municipalities, by establishing a maximum threshold amount of energy consumption charges that can be incurred by the municipalities. Any charges in excess of that maximum threshold will be paid by the municipalities based on the prevailing service rates in effect during the billing period. If the municipalities do not pay the amounts billed, they are subject to a possible service cancellation by the PREPA.

In addition to these energy consumption limits, the CELI will not be applicable to every municipal property or installation. It will only be available for those facilities used for the rendering of not-for-profit services to the community; for corporations that provide public health services; and for the consumption charges incurred by the public lighting infrastructure. Those municipal installations and properties used for for-profit activities or occupied by not-for-profit entities that do not provide municipal services or by persons and businesses that are not municipal entities are excluded from the CELI subsidy.

18. SUBSEQUENT EVENTS (CONTINUED)

Finally, the guidelines require that the municipalities implement efficiency and conservation measures for a reduction of 15% in the energy consumption to be incurred in the next three fiscal years. All of these requirements are effective beginning November 16, 2015 (fiscal year 2015-16).

Application of Chapter 9 of the Federal Bankruptcy Law to the Commonwealth of Puerto Rico and its Instrumentalities

A law project has been submitted to the Congress of the United States of America requesting the application of Chapter 9 of the Federal Bankruptcy Law to the Commonwealth of Puerto Rico and its instrumentalities. The benefits available under Chapter 9 would permit the Commonwealth to restructure its debt with its bondholders, with the purpose of decreasing the interest costs and debt service requirements that consume a significant part of the Commonwealth's operating budget. During the past months, the Governor and Resident Commissioner of Puerto Rico have been persistently lobbying for the approval of this law project, including various public hearings in Congress, arguing that the Commonwealth will incur in a default of its debt service requirements for the fiscal year 2015-16 citing that both the Governmental Development Bank of Puerto Rico and the Puerto Rico Treasury Department are suffering from severe cash flow shortfalls that put in jeopardy the fulfillment of their debt obligations. The continuing economic and fiscal crisis of the island will seriously affect the amount and quality of services provided to the citizenry and the amount of subsidies and funds provided by the state to the municipalities.

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	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES::				
Property taxes	$ 1,375,603	$ 1,375,603	$ 1,375,603	$ -
Municipal license taxes	1,241,249	1,241,249	1,165,084	(76,165)
Sales taxes	870,000	870,000	652,222	(217,778)
Intergovernmental	5,660,615	5,660,615	6,146,400	485,785
Construction excise taxes	420,132	420,132	363,733	(56,399)
Rent	128,400	128,400	96,465	(31,935)
Charges for services	209,000	209,000	130,448	(78,552)
Miscellaneous	417,500	417,500	156,793	(260,707)
Total revenues	10,322,499	10,322,499	10,086,748	(235,751)
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Mayor and municipal legislature	1,381,854	1,569,379	1,547,634	21,745
General government	4,057,265	3,813,826	4,146,626	(332,800)
Public safety	547,547	447,036	443,790	3,246
Public work	1,779,763	1,952,599	2,058,285	(105,686)
Culture and recreation	930,113	870,233	854,401	15,832
Sanitation	506,616	617,616	617,616	-
Health and welfare	1,087,241	1,019,710	960,242	59,468
Operating transfer out	32,100	32,100	31,950	150
Total expenditures, encumbrances and other financing uses	10,322,499	10,322,499	10,660,544	(338,045)
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	$ -	$ -	$ (573,796)	$ (573,796)

Explanation of Differences:

Sources/inflows of resources:	
Actual amounts (budgetary basis) “available for appropriation” from the budgetary comparison schedule	$10,086,748
Differences-budget to GAAP:	
GAAP adjustments to revenues	545,964
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances	$10,632,712
Uses/outflows of resources:	
Actual amounts (budgetary basis) “total charges to appropriations” from the budgetary comparison schedule	$10,660,544
Differences-budget to GAAP:	
Non-budgeted expenditures	325,859
Prior year encumbrances recorded as current year expenditures for GAAP basis	102,364
Current year encumbrances recorded as expenditures for budgetary purposes	(113,239)
Nonbudgeted transfer-out	(31,950)
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances	$10,943,578

See notes to the Budgetary Comparison Schedule-General Fund.

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Control

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2015 representing the Municipality's original budget. There were no supplemental appropriations for the year ended June 30, 2015.

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	$19,872
Total U.S. Department of Agriculture			**$19,872**
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Emergency Solutions Grants Program	14.231	N/A	7,867
Lower income Housing Assistance Program Section 8 Moderate Rehabilitation	14.856	N/A	618,274
Section 8 Housing Choice Voucher Program	14.871	N/A	495,086
Pass-through the Commonwealth of Puerto Rico – Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants – State's Program	14.228	Not Available	1,321,806
Total U.S. Department of Housing and Urban Development			**2,443,033**
U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN):			
Community Services Block Grant	93.569	Not Available	64,584
Child Care and Development Block Grant	93.575	Not Available	258,058
Total U.S. Department of Health and Human Services			**322,642**

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico - Emergency Management Agency			
Disaster Grants – Public Assistance	97.036	Not Available	106,219
Total U.S. Department of Homeland Security			**106,219**
TOTAL EXPENDITURES OF FEDERAL AWARDS			**$2,891,766**

The accompanying notes are an integral part of this schedule.

1. BASIS OF PRESENTATION:

Expenditures reported on the Schedule are reported on the modified-accrual basis of accounting, except for Section 8 Housing Choice Voucher Program (HCV). Expenditures are recognized when the related liability is incurred following the cost principles contained in OMB Circular A-87 Cost Principles for State, Local and Indian Tribal Governments, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Expenditures for HCV Program are reported on a statutory basis as required by the U.S. Department of Housing and Urban Development. Such expenditures should equal the net ACC subsidy for the PHA's fiscal period.

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

State or local government redistributions of federal awards to the Municipality, known as "pass–through awards", should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass–through entity and the identifying number assigned by the pass-through entity for the federal awards received as a sub recipient.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Expenditures of the federal awards as reported in the Statements of Revenues, Expenditures and Changes in Fund Balances – Governmental funds, are included within the Other Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Description	Other Governmental Funds
Per Schedule of Expenditures of Federal Awards	$ 2,891,766
Additional amount recorded as expenditures under modified accrual basis for Section 8 HCV Program	8,294
Non-federal awards expenditures	2,391,192
Total expenditures in the basic financial statements	**$ 5,291,252**

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

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arroyo, Puerto Rico**, (**Municipality**) as of and for the year ended June 30, 2015, which collectively comprise the **Municipality**'s basic financial statements and have issued our report thereon dated March 1, 2016. The report on the governmental fund financial statements was unqualified but the report on the government wide financial statements has an adverse opinion because we were unable to obtain competent evidential matter related to the solid waste landfill liability. 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.

Internal Control Over Financial Reporting

Management of the **Municipality** is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the **Municipality**'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **Municipality**'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the **Municipality**'s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses, and therefore, there can be ensurance that all deficiencies, significant deficiencies, or material weakness have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weakness and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs, as item **2015-004,** to be material weaknesses.

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

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany schedule of finding and questioned costs, as item **2015-001, 2015-002, 2015-003, 2015-004, 2015-005 and 2015-006** to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable ensurance about whether the **Municipality**'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

The **Municipality**'s response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the **Municipality**'s response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

López-Vega CPA, PSC

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 1, 2016

Stamp No. 2705513 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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

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

Compliance

We have audited the **Municipality of Arroyo**'s compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the **Municipality of Arroyo**'s major federal programs for the year ended June 30, 2015. The **Municipality of Arroyo**'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Arroyo**'s management. Our responsibility is to express an opinion on the **Municipality of Arroyo**'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 ensurance 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 of Arroyo**'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 of the **Municipality of Arroyo**'s compliance with those requirements.

In our opinion, the **Municipality of Arroyo** complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2015. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items **2015-007** and **2015-009**.

Internal Control Over Compliance

Management of the **Municipality of Arroyo** is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality of Arroyo**'s internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the **Municipality of Arroyo**'s internal control over compliance.

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questions costs as items **2015-007** and **2015-009**. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention b those charge with governance.

The **Municipality of Arroyo**'s responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit **Municipality of Arroyo**'s response and, accordingly, we express no opinion on the responses.

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Arroyo** in a separate letter dated March 1, 2016.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

López-Vega CPA PSC

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 1, 2016

Stamp No. 2705514 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	**Unmodified in the FFS and adverse in the GWFS**	
Internal control over financial reporting:		
Material weakness identified?	Yes X	No
Significant deficiencies identified not considered to be material weaknesses?	Yes X	None reported
Noncompliance material to financial statements noted?	Yes	No X

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes	No X
Significant deficiencies identified not considered to be material weaknesses?	Yes X	None reported
Type of auditor's report issued on compliance for major programs:	**Unmodified**	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes X	No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.856	Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation
14.871	Section 8 Housing Choice Voucher Program
14.228	Community Development Block Grants – State's Program

Dollar threshold used to distinguish between Type A and Type B programs	$300,000	
Auditee qualified as low-risk auditee?	Yes	No X

Section II – Financial Statements Findings

This significant deficiency in internal controls is considered an instance of noncompliance (NC).

Finding Reference **2015-001**

Requirement **Recognition and Reporting of Net Pension Liability – Cost Sharing Pension Plans (MW)**

Statement of Condition Management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. The amount by which this departure would affect the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the Municipality's governmental activities has not been determined.

In addition, the Municipality's financial statements do not disclose the descriptive information about the pension plans through which the pensions are provided required by the GASB Statement No. 68 for cost-sharing employers. Also, management has omitted historical pension information that accounting principles generally accepted in the United States of America required to be presented to supplement the basic financial statements.

Criteria GASB Statement No. 68 states the accounting and financial reporting requirements for pension plans provided to employees of state and local governments that are administered through cost-sharing pension plan trusts that comply with the criteria set forth in the Statement. This requires that the Municipality report in its financial statements its proportionate share of the collective net pension liability, pension expense and deferred outflows and inflows of resources related to pensions as of the measurement date. It also requires detailed disclosures related to the actuarial and financial information used in the calculation of the net pension liability and the reporting of historical pension data as Required Supplementary Information.

Cause of Condition The Municipality's pension plan administrator has not provided the audited actuarial and financial information necessary for the proper recognition and reporting of its net pension liability as of June 30, 2015.

Effect of Condition The Municipality's Government-Wide Financial Statements does not present fairly the financial position of the governmental activities, and the change in financial position of the Municipality.

Section II – Financial Statements Findings

Finding Reference **2015-001 (Continued)**

Recommendation We recommend the Municipality maintains a constant communication with the pension plan's administrator, the Commonwealth's Employees Retirement System Administration, in order to obtain the necessary audited actuarial and financial information necessary to comply with the requirements of the GASB Statement No. 68.

Questioned Cost None

Management Response and Corrective Action We concur with the auditors' recommendations. The Municipality is closely monitoring the actions of the Commonwealth's Employees Retirement System Administration in order to make sure to obtain the audited information required by this standard.

Implementation Date: Still in process

Responsible Person: Eugenia Devarie
Finance Department Director

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Section II – Financial Statements Findings

Finding Reference	**2015-002**
Requirement	**Operating deficit of general fund**
Statement of Condition	As of June 30, 2015, the Municipality closed with an accumulated deficit in its General Fund of ($985,126). The current year operation closed with a net change in fund balances in the General Fund amounting to $24,639. The Municipality does not provide sufficient resources in the budget of the fiscal year 2014-2015 to amortize the accumulated deficit.
Criteria	Article 7.011, Section (a) of Autonomous Municipal Act (Law 81) establishes that if the Municipal close its operations on deficit it must provide for sufficient resources to cover it during the next fiscal year. Section (b) establishes among other things, that; Provides that accrued deficit in The Municipality, by public debt, will be amortized in a period of 40 years. The equivalent amortization amount will be established in an expense account in the annual budget known as accrued deficit which will be indicated in the chart of accounts. Article 8.004 (b) establishes no amount shall be expended or obligated in a given fiscal year of if exceeds its budgeted or authorized amounts by the Municipal Legislation. Section 3 of the revised regulation over Basic Standards for Municipalities of Puerto Rico (The regulation) states that it must be special care to prepare the revenues estimates so these do not results in budget appropriations in excess of available resources.
Cause of Condition	The overstatement of estimated revenues and/ or the incurrence of obligations without credits available of this approved budgetary accounts caused the Municipality to operate with a deficit for several years.
Effect of Condition	The Municipality did not comply with the Article 7.011, Section (a), Article 8.004 (b) and Section 3 of the revised regulation over basic Standard for Municipalities of Puerto Rico
Recommendation	We recommend the Municipality to evaluate the adequacy of the provision for deficit reserve accounts in the next fiscal budget. Also, the Municipality's officers must evaluate the negative variances between budgeted revenues and actual revenues trend to reduce the budgeted expenses by department (quarterly allocation process) and to avoid future operational deficits at end of year.

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Section II – Financial Statements Findings

Finding Reference **2015-002 (Continued)**

Questioned Costs **None**

Management Response and Corrective Action

The Municipality should comply with law and regulation and should prepare a balance budget for the fiscal year 2016-2017. Also, during fiscal year 2015-2016, the Finance Director should monitor the actual revenues and expenditures in order to eliminate the accumulated deficit.

Implementation Date: June, 2016

Responsible Person: Eugenia Devarie
Finance Department Director

Section II – Financial Statements Findings

Finding Reference **2015-003**

Requirement **Financial Reporting – Accounting Records**

Statement of Condition During our examination of the Municipality's accounting system, we noted that the Municipality's accounting records for Local, State and Federal funds does not provide modified basis financial statements. Also, the accounting system does not offer subsidiaries to produce government wide financial statements. The computerized system provided by the Office of Commissioner of Municipal Affairs (OCAM) and manual system maintained by the finance department personnel do not provide adequate and effective financial information to generate the basic financial statements since the accounts balances were affected by accounting errors in the first years of the system operations.

Therefore, the Municipality hires the professional services of local accounting firms to perform the required adjustment entries to convert its accounting records from cash basis to modified and then to accrual basis and compile the necessary information as required by GAAP and Law 81.

Criteria Chapter VIII, Article 8.010 of the State Act Number 81 of August 30, 1991, states that the Municipality should maintain an effective and updated accounting system.

Cause of Condition The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.

Effect of Condition The Municipality's accounting system did not provide update and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.

Recommendation We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, inter fund transactions, etc.

Questioned Costs None

Management Response and Corrective Action The Municipality maintains two sets of accounting records; a manual system and a computerized system provided by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation. In addition, the auditors didn't qualify the government wide financial statements because all necessary information was provided: long-term debts were confirmed by the required Agencies and/or analysis for the

Section II – Financial Statements Findings

Finding Reference **2015- 003 (Continued)**

Management Response and Corrective Action (Continued)

Accruals were submitted, and adjustments were made; and fixed assets information was provided and adjusted. As explained in the condition of the finding, the information was provided to account for all transactions and no adjustments were provided by auditors, therefore, we understand that all required information was obtained and no adjustments or qualifications were made to the Financial Statements and no deficiency exists.

Implementation Date: June 2016

Responsible Person: Eugenia Devarie
Finance Department Director

Section II – Financial Statements Findings

Finding Reference	**2015-004**
Requirement	**Accounting Records- Municipal Solid Waste Landfill Closure and Post-closure Care and Maintenance Costs**
Statement of Condition	The Municipality did not adjust in its government wide financial statements, the required liability for closure and post closure costs based on an adequate study of the activities of the solid waste landfill. At June 30, 2015, the Municipality did not realize the required study of the available space and the estimated cost of the closing and post-closing of the Municipality's waste landfill. In addition, the amount of expenses recorded in the financial statements is based on an estimate made by the Municipality's management.
Criteria	Regulations set forth by the U.S. Environmental Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria"; the Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. GASB 18 requires the Municipality to perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality must recognize a liability in its statement of net assets at June 30, 2015.
Cause of Condition	The Municipality did not maintain an adequate control of the accountability of the closure and post closure care costs of Municipal solid waste landfill. In addition, the Municipality did not perform the study required by EPA and GASB 18.
Effect of Condition	The Municipality is not in compliance with GASB 18 and the "Solid Waste Disposal Facility Criteria" issued by the U.S. Environmental Protection Agency.
Recommendation	We recommend management to perform the study of the activities that need to be implement at the Municipality's solid waste landfill facilities and determine the amount of the liability that should be report in the governmental activities.
Questioned Cost	None.

Section II – Financial Statements Findings

Finding Reference	**2015-004 (Continued)**
Management Response	During the Transition Process, the Consulting Firm in charge of preparing the financial statements, notes and other supplementary information, informed to the new Administration that they only used the formula to compute the landfill closure and postclosure care costs and the liability recognized in the financial statement provided by auditors of the Municipality in previously audited financial statements. Accordingly, they ensumed that this method complied with GAAP. As explained in the condition of the finding, the expense and liability should be based on a study realized by the Municipality. We will further evaluate the calculation of closure and postclosure costs and will proceed with the requirements of the professional standards.

Implementation Date:	June 2016
Responsible Person:	Eugenia Devarie Finance Department Director

Section II – Financial Statements Findings

Finding Reference **2015-005**

Requirement **Municipal license tax revenues (MW)**

Statement of Condition Municipal license tax revenues of the fiscal year 2014-2015, which were collected in advance from taxpayers between January 1 thru June 30, 2015 (known in Spanish as "Patente en Suspenso"), were used by the Municipality to cover certain operating costs and cash flows shortages of the general fund during the fiscal year ended June 30, 2015. Those unearned revenues collected in advance pertain to the general fund's operating budget of the fiscal year 2015-2016, and must not be used to pay obligations of the prior year.

Criteria Article 8.004(b) of Law No. 81 of August 30, 1991, known as the Autonomous Municipalities Act of Puerto Rico (Law No. 81) states that the Municipality cannot use or obligate any amount in a given fiscal year that exceeds the appropriations and the resources authorized by ordinance or resolution for such fiscal year. In addition, the Municipality cannot be committed, in any form, to any contract or negotiation for the future payment of amounts that exceed the current fiscal year's budgeted resources.

Cause of Condition The foregoing condition is primarily due to the facts that the Municipality does not prepare cash flows forecasts and projections to anticipate any cash flows shortage. Management does not have timely and accurate information regarding its operations and cannot monitor the adherence to the established budget appropriations and cash flows.

Effect of Condition This situation will result in possible significant general fund limitations and eventual reduction or elimination of municipal services since future revenues were used to pay for accumulated liabilities.

Recommendation We recommend the Municipality to prepare cash flows forecasts and projections to anticipate any cash flows shortages and to avoid using financial resources of future fiscal years to cover the operating needs of the current fiscal year.

Questioned Costs None

Management Response and Corrective Action With the implementation of corrective actions taken to the Finding 2015-002, we expect to avoid or, at least, reduce the use of the license tax revenues collected in advance, in future fiscal years.

Implementation Date: Fiscal Year 2016

Responsible Person: Eugenia Devarie
Finance Department Director

Section II – Financial Statements Findings

Finding Reference **2015-006**

Requirement **Expenditures for Goods and Services and Accounts Payables-Purchasing and receiving**

Statement of Condition We performed a cash disbursements test and examined twenty six (26) payments which belonged to General Fund, twenty eight (28) which belonged to Others Funds, one (1) which belonged to Joint Resolution and five (5) which belonged to Community Development Block Grants – State's Program (CDBG). The following will summarize the internal control exceptions noted:

a. In sixteen (16) payments, ten (10) which belonged to General Fund, two (2) which belonged to Community Development Block Grants – State's Program (CDBG) and four (4) which belonged to Others Funds the disbursement vouchers did not include pre-intervention signatures.

b. In ten (10) payments six (6) which belonged to General Fund and four (4) which belonged to Others Funds the disbursement vouchers did not include the purchase order.

c. In eleven (11) payments five (5) which belonged to General Fund, one (1) which belonged to Joint Resolution and five (5) which belonged to Others Funds the disbursement vouchers did not include at least three quotations for the purchase.

d. In six (6) payments four (4) which belonged to General Fund, one (1) which belonged to Community Development Block Grants – State's Program (CDBG) and one (1) which belonged to Others Funds the disbursement vouchers did not include the invoice.

e. In three (3) payments one (1) which belonged to General Fund and two (2) which belonged to Others Funds the disbursement vouchers did not have all supporting documents stamped as paid.

f. In ten (10) payments five (5) which belonged to General Fund, one (1) which belonged to Community Development Block Grants – State's Program (CDBG) and four (4) which belonged to Others Funds the disbursement vouchers were not available for our examination

Criteria "Reglamento para la Administración Municipal" establish in the Chapter Four (4) that the Finance Director will be responsible to account and prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions.

Section II – Financial Statements Findings

Finding Reference	**2015-006 (Continued)**
Cause of Condition	The Municipality internal control procedures failed to ensure that all transactions include all the required documentation and approvals.
Effect of Condition	The Municipality is not in compliance with Chapter Four (4) of the "Reglamento para la Administración Municipal".
Recommendation	We recommend that the Municipality should improve its internal control and procedures in order to ensure that the disbursement vouchers contain all the necessary supporting documents before making the payments and are available for examination.
Questioned Costs	None
Management Response and Corrective Action	We are improving our internal controls in order to ensure that all required information is obtained before making a disbursement.
	Implementation Date: June 2016
	Responsible Person: Eugenia Devarie, Finance Department Director

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	**2015-007**
Program	**Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development**
Requirement	**Special Test – Depository Agreements**
Statement of Condition	During our audit, we noted that the Municipality did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999).
Criteria	Code of Federal Regulations 24, Subpart D, 982.156 states. (c) The PHA must enter into an agreement with the depositary in the form required by HUD. (d) If required under a written freeze notice from HUD to the depositary: (i) The depositary may not permit any withdrawal by the PHA of funds held under the depositary agreement unless expressly authorized by written notice from HUD to the depositary; and (ii) The depositary must permit withdrawals of such funds by HUD. (2) HUD must send the PHA a copy of the freeze notice from HUD to the depositary.
Cause of Condition	The program is not performing an effective review of compliance requirement that are required by HUD.
Effect of Condition	The PHA is not in compliance with laws and established regulation as prescribed by HUD.
Recommendation	Procedures should be implemented to ascertain that the PHA complies with the established Federal Regulation, as prescribed by HUD.
Questioned Costs	None
Management Response and Corrective Action	Depository agreements will be obtained to comply with federal regulations. Implementation Date: July 2016 Responsible Person: Juan Devarie Section 8 Program Coordinator

Section III – Major Federal Program Award Findings and Questioned Costs

Finding Reference	**2015-008**
Program	**Section 8 Housing Choice Vouchers (CFDA. No. 14.871); U.S. Department of Housing and Urban Development**
Requirement	**Reporting – Financial Reporting**
Statement of Condition	We performed a reporting test and noted that the audited financial data for the fiscal year 2014-2015 (submitted electronically) was not submitted to HUD through the Real Estate Assessment Center (REAC) in the stipulated time.
Criteria	24 CFR section 5.801 (b) *Submission of financial information.* Entities to which this subpart is applicable must provide to HUD, on an annual basis, such financial information as required by HUD. This financial information must be: (1) Prepared in accordance with Generally Accepted Accounting Principles as further defined by HUD in supplementary guidance; (2) Submitted electronically to HUD through the internet, or in such other electronic format designated by HUD, or in such non-electronic format as HUD may allow if the burden or cost of electronic reporting is determined by HUD to be excessive; and (3) Submitted in such form and substance as prescribed by HUD. (d) *Reporting compliance dates*. (1) for PHAs listed in paragraphs (a)(1) and (a)(2) of this section, the requirements of this section will begin with those PHAs with fiscal years ending September 30, 1999 and later. Unaudited financial statements will be required 60 days after the PHA's fiscal year end, and audited financial statements will then be required no later than 9 months after PHA's fiscal year end, in accordance with Single Audit and OMB Circular A-133 (24 CFR 84.26).
Cause of Condition	The Program did not submit timely the audited financial data as required by 24 CFR section 5.801 and by HUD.
Effect of Condition	The PHA is not in compliance with 24 CFR 5.801 and as prescribed by HUD.
Recommendation	Procedures should be implemented to ascertain that the PHA complies with the established Federal Regulation and as prescribed by HUD.
Questioned Costs	None

Section III – Major Federal Program Award Findings and Questioned Costs

Finding Reference **2015-008 (Continued)**

Management Response and Corrective Action

The Municipality management agrees with the finding. The Municipality's Management instructs the program accountant to submit timely GAAP-based audited financial information electronically to HUD once the Single Audit Report package is available.

Implementation Date: Fiscal Year 2016-2017

Responsible Person: Juan Devarie
Federal Program Director

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **2015-009**

Program **Community Development Block Grants – State's Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)**

Requirement **Davis-Bacon Act**

Statement of Condition During our Davis-Bacon Act test, we verified (3) construction project file. The following will summarize the exceptions noted:

a) For two (2) construction project, we noted that during the fiscal year 2014-2015, the Municipality did not inform to the contractor in the procurement process of the requirements for Davis Bacon Act prevailing wage rates notice`;

b) For the two (2) construction projects, the contractor did not submit all the weekly certified payrolls during the contracts period;

c) For the three (3) construction projects, the contract did not contains provisions for payment of prevailing wage rates, compliance with Davis Bacon Act requirements

Criteria Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).

Cause of Condition The Municipality's controls and procedures failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.

Effect of Condition The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).

Recommendation We recommend that the Municipality should maintain supporting evidence for all construction projects.

Questioned Costs None

Management Response and Corrective Action All files have been revised in order to ensure compliance with applicable federal statues. The Director has been instructed to establish an internal work to examine internal policies and procedures regarding to Davis Bacon. All file will be revised to include all information required in accordance with Federal Regulations.

Implementation Date: July 2016

Responsible Person: Héctor Caraballo
Federal Programs Department Director

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
14-05	14.871	During our audit, we noted that the Municipality did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999). No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference **2015-007.**
14-06	14.871	The PHA did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2014. The PHA did not perform a review of the utility rates during the fiscal year to ascertain if there has been a change of ten (10) percent or more in the utility rate. Corrective action has been taken.
14-07	14.871	During our audit, we noted that the Municipality did not comply with the compliance requirement of Housing Quality Control re-inspections during the fiscal year 2013-2014. The following will summarize the exception not a) ed:We noted that during the fiscal year after our review, the quality control re-inspections were conducted three (3) to fifty eight (58), more than ninety (90) days after the original inspection. Corrective action has been taken.
14-08	14.228	We performed a housekeeper activity test of fifteen (15) participant's files and found the following exceptions: a) In four (4) participant's files, we noted that the service contract (Form OCAM-AH-005) that established the service plan to be offered by the CDBG Program between the Municipality and the participant was not available for our examination. b) In the fifteen (15) participant's files, although we did not find evidence that visits were performed during the contract period, the program staff did not visited at least twice per month the participant's housing unit to ensure the quality of services, according to the activity procedures guide. c) In the seven (7) participant's files, we noted that the contracts formalized by the Program did not establish the services to be offered. Also, the eligibility approval forms were not completed by the program staff. d) In five (5) participant's files, we noted that, as part of the visits procedures, the Service Coordinator did not document in the Form OCAM-AH-006, the housekeeper performance. e) In one (1) participant's files was not available for our examination. Corrective action has been taken.

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
14-09	14.228	During our Davis-Bacon Act test, we verified (1) construction project file with a cost of $74,999.63. The following will summarize the exceptions noted: a) We noted that during the fiscal year 2013-2014, the construction project file was not available for our examination. No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference **2015-009**
14-09	14.228	During our audit of the program income requirements, we noted that the Municipality did not maintain internal controls to ensure the proper determination, accounting and use of program income, as discuss below: a) Program income records were not available for our examination. b) Program income was not reported in accordance with the program requirements and other regulations applicable. Corrective action has been taken.
13-05	14.871	Of a sample of ten (10) disbursements examined, two (2) disbursement orders did not have the signature of the Pre-intervention Officer. Corrective action has been taken.
13-06	14.871	Two (2) disbursements made for purchases under $10,000, from a sample of ten (10) disbursements examined, did not include as part of the supporting documents written quotations as evidence of price solicitation to suppliers. Corrective action has been taken.
13-07	14.871	Of a sample of ten (10) disbursements examined of Housing Choice Vouchers program and ten (10) disbursements examined of Section 8 Moderate Rehabilitation program. a) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a purchase under $10,000, does not include a written certification stating that merchandise was received and agrees in quantities and specifications to the purchase order, and. b)Six (6) disbursements belonging to the Housing Choice Vouchers program and eight (8) disbursements belonging to the Moderate Rehabilitation program, made for HAP payments, did not have a list or schedule supporting the amount paid. c) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a transaction over $10,000, did not have a list or schedule supporting the amount paid and. d) One (1) disbursement belonging to the Moderate Rehabilitation program, made for a transaction over $10,000, the disbursement order and its supporting documents was not available. Corrective action has been taken.

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
13-08	14.228	We requested two (2) contractor's payroll in order to verify the wage rates paid by the contractor and if laborers and mechanics were paid full amounts accrued at time of payment, computed at wage rates not less t those stated in the advertised specifications. For one contract the Federal Awards Department of the Municipality did not perform the procedure . Corrective action has been taken.
13-05	14.871	Of a sample of ten (10) disbursements examined, two (2) disbursement orders did not have the signature of the Pre-intervention Officer. Corrective action has been taken.
13-06	14.871	Two (2) disbursements made for purchases under $10,000, from a sample of ten (10) disbursements examined, did not include as part of the supporting documents written quotations as evidence of price solicitation to suppliers. Corrective action has been taken.
13-07	14.871	Of a sample of ten (10) disbursements examined of Housing Choice Vouchers program and ten (10) disbursements examined of Section 8 Moderate Rehabilitation program. a) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a purchase under $10,000, does not include a written certification stating that merchandise was received and agrees in quantities and specifications to the purchase order, and. b)Six (6) disbursements belonging to the Housing Choice Vouchers program and eight (8) disbursements belonging to the Moderate Rehabilitation program, made for HAP payments, did not have a list or schedule supporting the amount paid. c) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a transaction over $10,000, did not have a list or schedule supporting the amount paid and. d) One (1) disbursement belonging to the Moderate Rehabilitation program, made for a transaction over $10,000, the disbursement order and its supporting documents was not available. Corrective action has been taken.

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
13-08	14.228	We requested two (2) contractor's payroll in order to verify the wage rates paid by the contractor and if laborers and mechanics were paid full amounts accrued at time of payment, computed at wage rates not less than those stated in the advertised specifications. For one contract the Federal Awards Department of the Municipality did not perform the procedure . Corrective action has been taken. .
13-09	14.856	Of a sample of nine (9) tenants files selected for our test, we found the following: a)Tenant file was not available, 1 instance, representing 11% of sample. Corrective action has been taken.
13-10	14.856	Of a sample of nine (9) tenants files selected for our test, we found the following. a) Tenant income for Temporary Assistance for Needy Families was not accurately recorded in form HUD-50058, 1 instance, representing 11% of sample, Corrective action has been taken.
13-11	14.871	The Municipality did not have written policies in its Housing Choice Voucher Program (HCVP) administrative plan for selecting applicants from the waiting list. Corrective action has been taken.
13-12	14.228	1-Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property, and 2)A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years. Corrective action has been taken.

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
13-14	14.856	The Municipality did not provide a reserve for replacement account and could not provide evidence of the required monthly deposit to the account Corrective action has been taken.
13-15	14.871	The Municipality did not comply with the compliance requirement of Depositary Agreements. The Public Housing Agencies (PHA) is required to enter into depositary agreement with their financial institutions in the form required by HUD. (Form HUD-51999) No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference **2015-007**.
12-05	14.856	In our audit process, we could not identify that a replacement reserve was properly established, required monthly deposits were made, or that disbursements were only for approved purposes. The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse..
12-06	14.871	In our Waiting List test, we noted the following situations: a) The PHA did not have written policies in its HCVP administrative plan for selecting applicants from the waiting list. b) The PHA has no evidence of the public notice to the families when it opened and closed the waiting list. The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse..
12-07	14.871	During our audit, we noted that the Municipality did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999) The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse.

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
12-08	14.228	During our Davis-Bacon Act test, we verified one (1) construction project. The following will summarize the exceptions noted: a) We noted that during the fiscal year 2011-2012, the Municipality did not apply adequate monitoring procedure to required on-site visits to monitor the classifications of workers and wage rates paid. b) We did not obtain evidence that the Municipality's monitors certified the weekly payroll supplied by the contractors. c) The contractor did not submit the certifications and copies of payroll. (Weekly payroll) The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse.
12-09	14.228	During our audit of the program income requirements we noted that the Municipality did not maintain internal controls to ensure the proper determination, accounting and use of program income, as discuss below: a) Program income records were not available for our examination. a) Program income was not reported in accordance with the program requirements and other regulations applicable. The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse..
12-10	93.575	During our audit, we noted that the Municipality did not maintain adequate accounting records for the Child Care and Development Block Grant Program. However, the Municipality hires the professional services of external accountants to perform the trial balance of the program. These accountants obtain the information from various sources, departments and persons within the Municipality. The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse.