

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

**MUNICIPIO DE LUQUILLO
AUDITORÍA 2014-2015**

30 DE JUNIO DE 2015

COMMONWEALTH OF PUERTO RICO MUNICIPALITY OF LUQUILLO



***BASIC FINANCIAL STATEMENTS, REQUIRED
SUPPLEMENTARY INFORMATION AND
INDEPENDENT AUDITORS' REPORT***

***(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)***

***AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2015***



Hon. Jesús Marquez- Rodriguez
Mayor

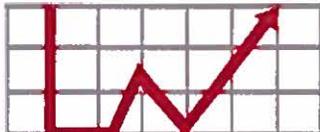
Mr. Ismael Ortiz
Finance Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO**

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FINANCIAL SECTION



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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- 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 Luquillo
Luquillo, Puerto Rico**

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo**, Puerto Rico (the 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 misstatement, whether due to fraud or error.

Auditors' 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. 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 auditors' judgment, including the assessment of risks 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 evaluating 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.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Summary of Opinions

<u>Opinion Unit</u>	<u>Type of Opinion</u>
Governmental Activities	Qualified
Business-type Activities	Unmodified
General Fund	Unmodified
Community Development Block Grant Program Fund	Unmodified
Bonds and Notes Issuance Fund	Unmodified
Law No. 212 Fund	Unmodified
Debt Service Fund	Unmodified
Municipal Enterprise Centro Diagnóstico y Tratamiento Fund	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Qualified Opinion on Governmental Activities

As indicated in Notes A and N, the Municipality's employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plan administered by the Employees' Retirement System Administration of the Government of the Commonwealth of Puerto Rico. The deferred outflows/inflows of resources and the net pension liability of \$1,338,060, \$181,968 and \$22,739,173, respectively, reported in the governmental activities of the government-wide Statement of Net Position as of June 30, 2015, and the pension expense of \$1,304,058 for the current period change of that liability in the governmental activities of the government-wide Statement of Activities, were derived from the amounts reported as the Municipality's proportionate share of the net pension liability, deferred outflows/inflows of resources and pension expense in the *GASB 68 Collective and Allocated Amounts Schedule* included in the Circular Letter No. 1300-23-16 issued by the Puerto Rico Department of Treasury. This Schedule states that the information disclosed as of June 30, 2014 (the pension plan's measurement date) was not audited and subject to change. These amounts represent 100 percent, 52 percent, and 26 percent of the deferred outflows of resources, liabilities and deferred inflows of resources as of June 30, 2015, respectively, and 8 percent of the expenses for the fiscal year then ended. We were unable to obtain sufficient appropriate audit evidence about the proportional share used to determine the deferred outflows/inflows of resources, net pension liability and pension expense of the governmental activities. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion, except for the possible effects of the matter discussed in the "Basis for Qualified Opinion on Governmental Activities" paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the **Municipality of Luquillo**, Puerto Rico, as of June 30, 2015, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.



INDEPENDENT AUDITORS' REPORT (CONTINUED)

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo**, Puerto Rico, as of June 30, 2015, and the respective changes in financial position 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 on pages 9 through 22, Budgetary Comparison information on page 78, and the Schedules of Municipality's Proportionate Share of Net Pension Liability and of Municipality's Contributions on page 81, 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Luquillo's** basic financial statements. The accompanying supplementary information – Financial Data Schedule shown in pages 84 and 85 is presented for purposes of additional analysis as required by the U.S. Department of Housing and Urban Development, Office of the Inspector General, and is not a required part of the financial statements. The accompanying supplementary information – Schedule of Expenditures of Federal Awards shown in page 87 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements.

The Financial Data Schedule and 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 basic 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 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 Financial Data Schedules and the Schedule of Expenditures of Federal Awards are fairly stated in all material respects in relation to the basic financial statements as a whole.



INDEPENDENT AUDITORS' REPORT (CONTINUED)

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated August 31, 2016, on our consideration of the Municipality's 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 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 Municipality's internal control over financial reporting and compliance.


LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
August 31, 2016

Stamp No. 2728529 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



MANAGEMENT'S DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

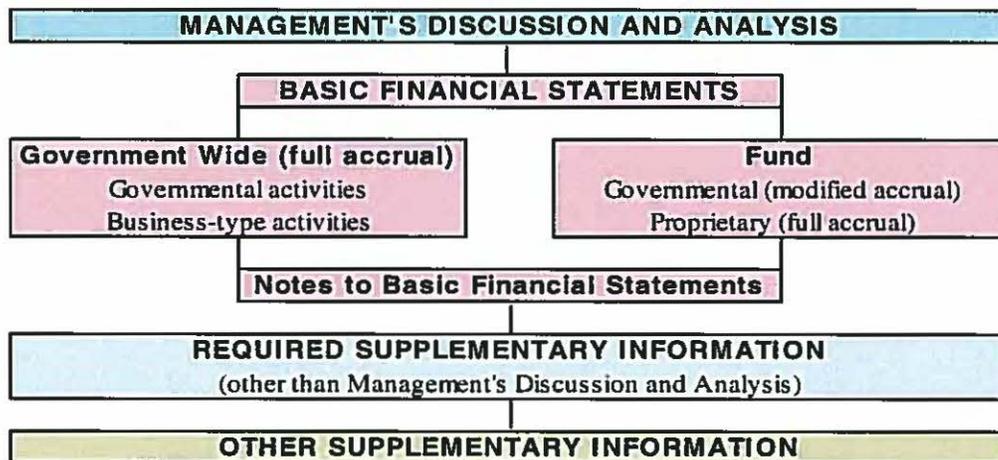
The discussion and analysis of the Municipality of Luquillo's ("the Municipality") financial performance provides an overall review of the Municipality's financial activities for the year ended June 30, 2015. The intent of this discussion and analysis is to look at the Municipality's financial performance as a whole; this section should be read in conjunction with the basic financial statements to obtain a better understanding of the financial position and the results of operations of the Municipality. Our analysis follows this section.

FINANCIAL HIGHLIGHTS

- On a government-wide basis, total assets and deferred outflows of the Municipality exceeded its liabilities and deferred inflows of resources at the close of fiscal year 2015 by \$18,541,870 (net position). Of this amount, \$(20,337,289) represents the unrestricted net deficit. This unrestricted deficit is the result of the implementation of GASB Statement No. 68 "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27" and GASB Statement No. 71 "Pension Transition for Contributions Made Subsequent to the Measurement Date".
- With respect to 2015, the Municipality's governmental activities revenues and expenses increased 4% and 8% respectively. Business-type activities started operations during the fiscal year 2015.
- A net change (decrease) in the fund balances of the Municipality's governmental funds of \$181,750 in the fiscal year 2015 resulted in reported ending fund balances of \$9,197,625, with no significant change with respect to 2014 year. Approximately 31% of the total fund balances is unrestricted (committed, assigned or unassigned).
- For the fiscal year 2015, the General Fund reported an excess of revenues and other financing sources over expenditures and other financing uses of \$814,552. The unassigned fund balance amounts to \$2,209,265 with an increase of 12% as compared to 2014.
- The investment in capital assets (total primary government) as of June 30, 2015 was \$47,219,350 (net of depreciation).
- Long-term debt increased to \$41,302,241 as a result of the implementation of GASB Statements No. 68 and 71.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$242,410.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's financial report comprises four components: (1) management's discussion and analysis (presented here), (2) basic financial statements, (3) required supplementary information and (4) other supplementary information:



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

The Municipality's basic financial statements consist of two kinds of statements, the government-wide and the fund financial statements, as follows:

Basic Financial Statements

▪ ***Government-Wide Financial Statements***

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the *statement of net position* presents all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference reported as net position. Over time, increases or decreases in the Municipality's net position are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's capital assets may need to be considered to assess the overall health of the Municipality. The second statement – the *statement of activities* – presents information showing how the net position changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid. The government-wide statements are divided into two categories:

Governmental Activities: Most of the Municipality's basic services are reported here including: public works and sanitation, public safety, culture and recreation, housing, welfare, and community development, education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

Business-type Activities: Business-type activities charge fees to customers to finance the costs of their activities. The activities of *Municipal Enterprise Centro de Diagnostico y Tratamiento* (the only business-type activity) are included here.

▪ ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality's most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well as by bond covenants. The Municipality has two kinds of funds: governmental and proprietary funds.

Governmental funds: The Municipality's basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified-accrual basis of accounting. Under this approach, the financial statements focus on near-term inflows and outflows of external resources, as well as on balances of spendable resources available at year-end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

Proprietary funds: Services for which the Municipality charges customers a fee are generally reported as proprietary funds. These funds, like the government-wide statements, provide both long-term and short-term

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financial information and are accounted for using the economic resources measurement focus and the accrual basis of accounting. The Municipality's proprietary funds consist of an enterprise fund, the same as the business-type activities. The Municipality reports the activities of *Municipal Enterprise Centro de Diagnostico y Tratamiento* as an enterprise fund.

The fund statements focus on major funds. The Municipality's major governmental and enterprise funds are funds that comply with a minimum criterion that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official's criteria if the fund is particularly important to financial statement users. Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds or other nonmajor enterprise funds.

▪ **Notes to financial statements**

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information: The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund, the schedule of Municipality's proportionate share of net pension liability and the schedule of Municipality's contributions.

Supplementary information: The supplementary information also includes a financial data schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Position: The following table presents a summary of the Statements of Net Position as of June 30, 2015 and 2014:

TABLE 1

	Governmental Activities		Business-type Activities		Total Primary Government	
	2015	2014	2015	2014	2015	2014
Assets						
Current and other assets	\$ 13,934,652	\$ 14,970,573	\$ 103,533	\$ -	\$ 14,038,185	\$ 14,970,573
Total capital assets, net	47,219,350	47,082,807	-	-	47,219,350	47,082,807
Total assets	61,154,002	62,053,380	103,533	-	61,257,535	62,053,380
Deferred outflows of resources	1,338,060	-	-	-	1,338,060	-
Liabilities						
Current and other liabilities	2,038,210	2,485,717	-	-	2,038,210	2,485,717
Long-term liabilities:	41,302,241	19,606,021	-	-	41,302,241	19,606,021
Total liabilities	43,340,451	22,091,738	-	-	43,340,451	22,091,738
Deferred inflows of resources	713,274	536,938	-	-	713,274	536,938
Net position						
Net investment in capital assets	33,472,946	32,628,575	-	-	33,472,946	32,628,575
Restricted	5,406,213	5,096,375	-	-	5,406,213	5,096,375
Unrestricted	(20,440,822)	1,425,224	103,533	-	(20,337,289)	1,425,224
Total net position	\$ 18,438,337	\$ 39,150,174	\$ 103,533	\$ -	\$ 18,541,870	\$ 39,150,174

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

The Municipality implemented GASB Statement No. 68 effective July 1, 2014. The 2014 amounts presented have not been restated to reflect the implementation of GASB Statements 68 and 71.

Over time, net position (difference of non-fiduciary assets, deferred outflows versus liabilities and deferred inflows) may serve as a useful indicator of a government's financial position. Over time, increases or decreases in the Municipality's net position is one indicator of whether its financial health is improving or deteriorating. At June 30, 2015, assets and deferred outflows exceeded its liabilities and deferred inflows by \$18,541,870. Of this amount, \$(20,337,289) represents unrestricted net position, which may be used to meet the government's ongoing obligations to citizens and creditors. This unrestricted deficit is the part of net position that can be used to finance day-to-day governmental operations without constraints established by debt covenants, enabling legislation or other legal requirements. This deficit primarily arises from the implementation of GASB Statements 68 and 71. In order to implement the Statements, a prior period adjustment was made to the Municipality's July 1, 2014 net position. This prior period adjustment and other miscellaneous adjustments decreased the net position at beginning of year by \$21,115,464 from \$39,424,704 to \$18,309,240. Restricted net position represents resources that are subject to external restrictions on how they may be used.

The largest portion of the Municipality's net position reflects its investment in capital assets (land, buildings, equipment, and infrastructure) less accumulated depreciation and less any related outstanding debt used to acquire those assets. The Municipality uses these assets to provide services to its citizens and, consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources because capital assets are not generally liquidated for the purpose of retiring debt.

Changes in net position

The following table summarizes the changes in net position for the fiscal years ended 2015 and 2014:

TABLE 2

	Governmental Activities		Business-type Activities		Total Primary Government	
	2015	2014	2015	2014	2015	2014
Program revenues:						
Fees, fines and charges for services	\$ 1,204,936	\$ 2,187,842	\$ 36,317	\$ -	\$ 1,241,253	\$ 2,187,842
Operating grants and contributions	2,956,867	1,885,908	-	-	2,956,867	1,885,908
Capital grants and contributions	496,268	1,128,587	-	-	496,268	1,128,587
General revenues:						
Property taxes	3,881,262	4,089,947	-	-	3,881,262	4,089,947
Municipal license taxes	847,246	902,491	-	-	847,246	902,491
Sales and use taxes	1,639,039	1,440,949	-	-	1,639,039	1,440,949
Grants and contributions not restricted to specific programs	4,939,317	4,148,384	-	-	4,939,317	4,148,384
Interest and other	1,090,481	598,471	-	-	1,090,481	598,471
Total revenues	17,055,416	16,382,579	36,317	-	17,091,733	16,382,579

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

TABLE 2 – Continued

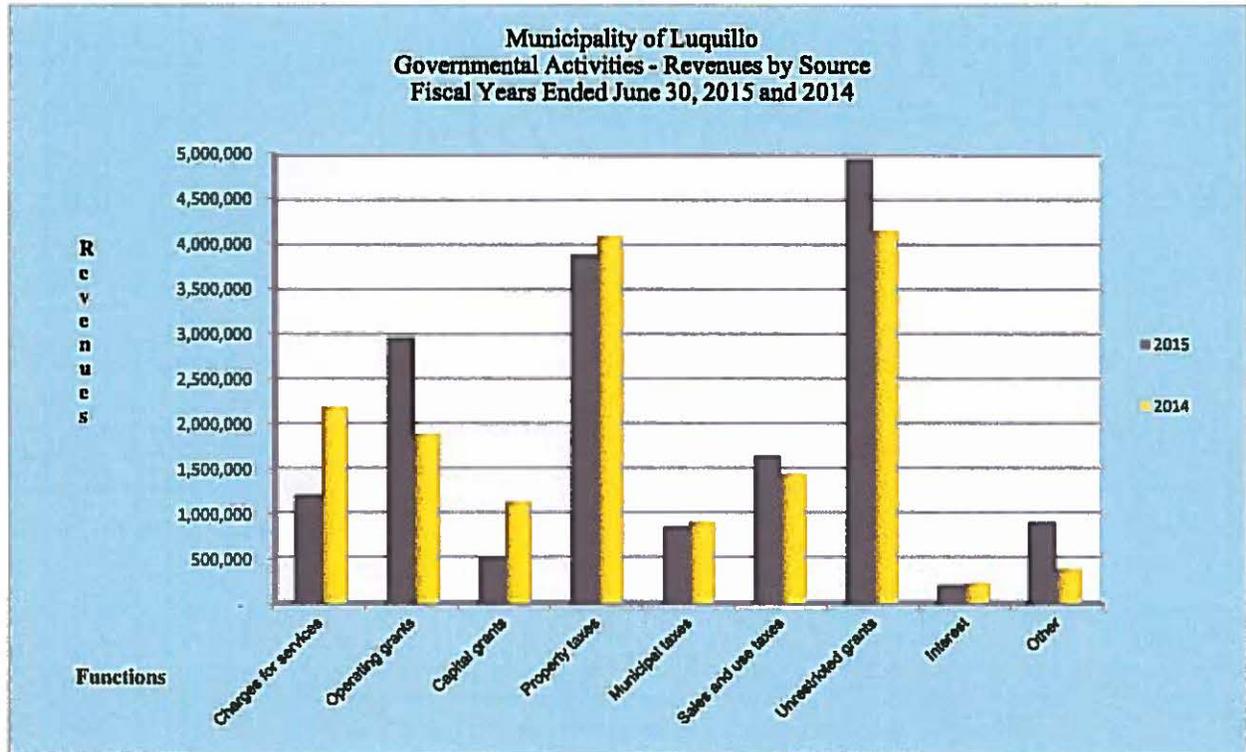
	Governmental Activities		Business-type Activities		Total Primary Government	
	2015	2014	2015	2014	2015	2014
Expenses:						
General government	7,652,150	6,971,792	-	-	7,652,150	6,971,792
Public works and sanitation	3,471,707	3,615,573	-	-	3,471,707	3,615,573
Public safety	296,916	286,215	-	-	296,916	286,215
Culture and recreation	784,808	882,254	-	-	784,808	882,254
Health	260,004	341,684	403,321	-	663,325	341,684
Housing, welfare and community development	3,275,018	2,637,816	-	-	3,275,018	2,637,816
Education	20,241	5,580	-	-	20,241	5,580
Interest on long-term debt	694,938	736,429	-	-	694,938	736,429
Total expenses	16,455,782	15,477,343	403,321	-	16,859,103	15,477,343
Increase (decrease) in net position before transfers	599,634	905,236	(367,004)	-	232,630	905,236
Transfers	(470,537)	-	470,537	-	-	-
Change in net position	129,097	905,236	103,533	-	232,630	905,236
Net position at beginning of year, as previously reported	39,150,174	38,244,938	-	-	39,150,174	38,244,938
Prior period adjustments	(20,840,934)	-	-	-	(20,840,934)	-
Net position at beginning of year, as restated	18,309,240	38,244,938	-	-	18,309,240	38,244,938
Net position at end of year	\$ 18,438,337	\$ 39,150,174	\$ 103,533	\$ -	\$ 18,541,870	\$ 39,150,174

The Municipality implemented GASB Statement No. 68 effective July 1, 2014. The 2014 amounts presented have not been restated to reflect the implementation of GASB Statements 68 and 71.

The Municipality (total primary government) reported a positive change in net position of \$232,630 a decrease of (\$672,606) or 74% with respect to the net change in net position reported in fiscal period 2014. This decrease resulted from the net effect of an increase of 4% in revenues and a net increase of 8% in expenses. The following **FIGURE 1** illustrates the Municipality's revenues comparison between 2015 and 2014:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

FIGURE 1



Revenues, governmental activities – As shown in TABLE 2, the three major sources of revenues of the Governmental Activities of the Municipality in fiscal year 2015 are: unrestricted grants and contributions (29%), property taxes (23%) and operating grants (17%). Revenues reported a net increase of 4% with respect to prior year. The most significant revenue variances occurred in:

- Other revenues increase (137%) – the increase is due to the recognition in 2015 of the donation of the health center from the Puerto Rico Department of Health for a total amount of \$700,000. On these facilities is located and operating the Municipal Enterprise Centro de Diagnóstico y Tratamiento, a blended enterprise fund.
- Operating grants increase (57%) – the Municipality recorded an increase of \$767,828 in 21st Century grant funds as compared with 2014.
- Capital grants decrease (56%) – due to a decrease in Commonwealth Legislature Resolutions revenues during 2015.
- Fees, fines and charges for services decrease (45%) - decrease occurred mainly due to a reduction in the compensation in lieu of tax (“CELI”) from PREPA reported in 2015. The compensation in lieu of tax (“CELI”) reported as government-wide revenue of \$1,008,057 represents an estimated amount since PREPA has not reported to the Municipality the actual CELI to be reported for the fiscal year 2014-2015. For the 2014 year, the actual CELI reported as government-wide revenue amounted to \$1,790,389.

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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Revenues, business-type activities – revenues of business-type activity of *Municipal Enterprise Centro de Diagnóstico y Tratamiento* consists mainly of charges for services – contract fees from a private medical provider and an operating grant from the Municipality. The Municipal Enterprise started operations in October 2014.

Expenses, governmental activities - The Municipality's government-wide expenses cover a range of services. The largest expenses are general government with 46%, public works and sanitation with 21% and housing, welfare and community development with 20%, as illustrated in **FIGURE 2**:

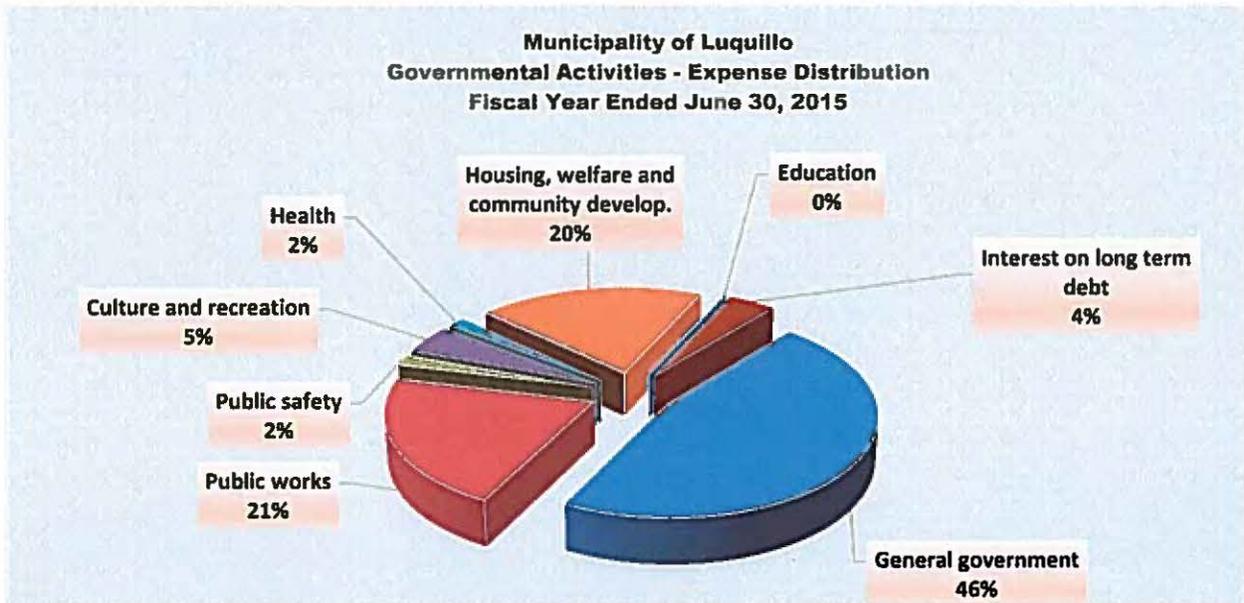
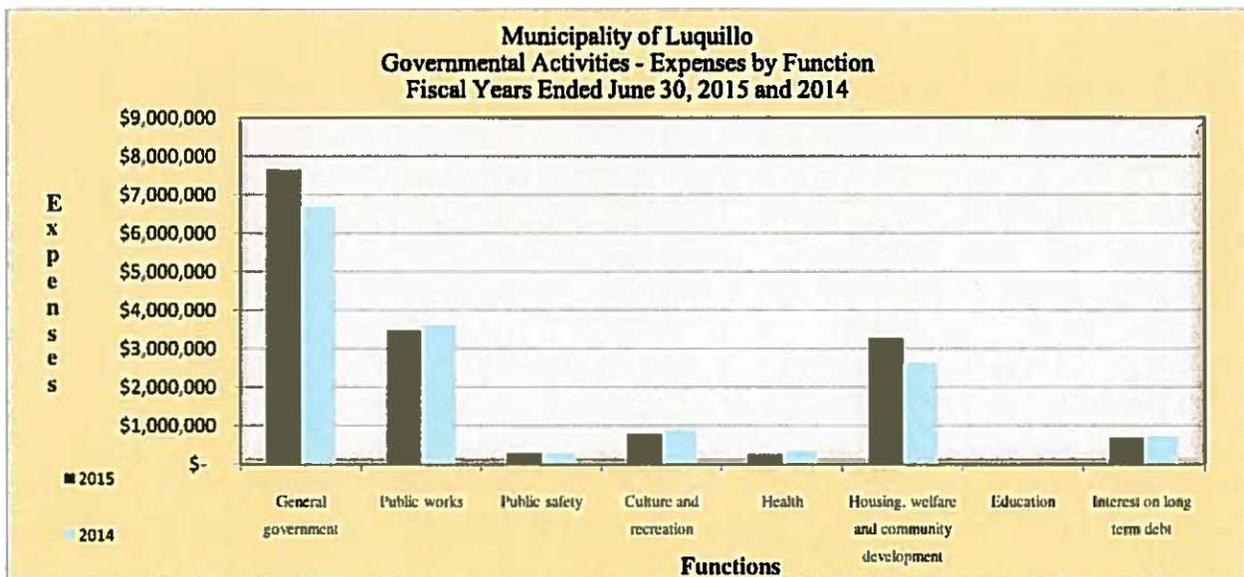


FIGURE 3



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

Total expenses of governmental activities increased 8% when compared with fiscal year 2014. Major increases occurred in general government (15%) and housing, welfare and community development (24%) functions.

The increase in general government is the net effect of several variances, the most significant increases in employer contributions to the retirement plan of \$643,948 due to the implementation in 2015 of GASB Statement 68; accrual of claims and judgments of \$288,000; salary of irregular employees of \$508,000; increase in other expenses of \$118,000; a net of a decrease of \$112,853 in vacation expense and \$782,000 in electric power utility expense consistent with the reduction of the CELI as disclosed before. The increase in housing, welfare and community development expense is due to an increase of \$650,105 in the 21th Century grant consistent with the related increase in this grant's revenues.

Expenses, business-type activities - expenses of business-type activity of *Municipal Enterprise Centro de Diagnóstico y Tratamiento* consists of professional services (grant of funds transfer to medical provider) and other operational expenses. The Municipal Enterprise started operations in October 2014.

The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. The following **TABLE 3** discloses 2015 and 2014 governmental activities expenses net of program revenue and the general revenues available to finance remaining costs:

TABLE 3

<i>Net Cost of Municipality's Governmental Activities For the years ended June 30,</i>		
	Net Costs of Services	
	2015	2014
Governmental activities:		
General government	\$ (6,152,447)	\$ (4,749,091)
Public works and sanitation	(2,850,439)	(2,486,986)
Public safety	(296,916)	(223,156)
Culture and recreation	(762,688)	(882,254)
Health	(260,004)	(341,684)
Housing, welfare and community development	(760,038)	(849,826)
Education	(20,241)	(5,580)
Interest on long-term debt	(694,938)	(736,429)
Total expenses, net of program revenues	(11,797,711)	(10,275,006)
General revenues:		
Taxes	6,367,547	6,433,387
Grants and contributions not restricted to specific programs	4,939,317	4,148,384
Interest and other	1,090,481	598,471
Transfers	(470,537)	-
Total general revenues	11,926,808	11,180,242
Change in net position	\$ 129,097	\$ 905,236

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

The Municipality implemented GASB Statement No. 68 effective July 1, 2014. The 2014 amounts presented have not been restated to reflect the implementation of GASB Statements 68 and 71.

Some of the cost of governmental activities was paid by those who directly benefited from the programs (fees and charges for services) (\$1,204,936) and other governments and organizations that subsidized certain programs with capital and operating grants (\$3,453,135). The net cost of services (\$11,797,711) was fully covered by other general revenues.

Expenses of the business-type activity were fully covered by charges for services and transfers of funds from the Municipality.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds - The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by an external party.

For the fiscal year ended June 30, 2015, the governmental funds reported ending fund balances of \$9,197,625, a net increase of \$181,750 in comparison with the prior year. Of the total fund balances, \$2,816,199 (or 31%) constitutes unrestricted fund balance, of which \$896,905 (or 10%) is unassigned funds. The remainder of the fund balances is restricted to indicate that it is not available for new spending. Following is a summary of the financial analysis of the Municipality's major funds:

- **General Fund** - The general fund is the operating fund of the Municipality. The fund balance of the general fund of \$4,128,559 represents approximately 45% of total ending fund balances. Of the total fund balance, 46% is assigned for public works, public safety, culture and recreation, welfare, capital outlays, and general government purposes. The remainder of \$2,209,265 is unassigned fund balance, which represents 54% of the total fund balance. This unassigned fund balance increased 12% with respect to the prior year.

During the fiscal year, the net change fund balance of the general fund amounts to \$814,552, a net decrease of 57% when compared with the 2014 net change in fund balance, as restated. The Municipality suffered a decrease in general fund operational revenues of \$737,114 or 7%; expenditures increased by \$370,127 of 3%. The decrease in revenues was mainly caused by the following:

- a) Property taxes decrease (17%) - the Municipality reported less current year "non-exonerated" property taxes with respect to the prior fiscal year and less revenue for a property tax amnesty applicable to 2014.
- b) Fees, fines and charges for services decrease (15%) - due to a reduction in revenues from construction excise tax and in the compensation in lieu of tax ("CELI") from PREPA reported in 2015 as indicated earlier. The compensation in lieu of tax ("CELI") reported as revenue represents an estimated amount since PREPA has not reported to the Municipality the actual CELI to be reported in fiscal year 2014-2015.

These decreases were counterbalanced by other financing sources of \$1,862,819 representing transfers from the CAE and IVU Municipal Redemption Funds for funds in excess of debt service requirements, interest income generated in other funds and transfers from other governmental funds.

**COMMONWEALTH OF PUERTO RICO
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YEAR ENDED JUNE 30, 2015**

- **Community Development Block Grant Program Fund (“CDBG”)** - The CDBG Fund is composed of the CDBG “State’s Program and Non-Entitlement Grants”, received through the Office of Commissioner of Federal Affairs. There were no significant variances in fund’s revenues and expenditures with respect to 2014. With respect to previous year, the CDBG fund operation presents an increase in revenues of \$86,684 and an increase in expenditures of \$9,602. The most significant expenditures include improvements for streets and roads, assistance to the elderly and administrative costs. Fund balance presents a deficit as liabilities and deferred inflows of resources exceed assets for unavailable revenues recorded.
- **Bonds and Notes Issuance Fund** - This fund reports financial resources from bond proceeds and notes issuances which are restricted for acquisition or construction of capital assets. No new debt was issued during 2015 as access to markets and the participation of the Municipality in the bond market has been delayed waiting for the credit rating of the Commonwealth and its instrumentalities to improve or for more favorable market conditions. There were no significant expenditures during 2015.
- **Law No. 212 Fund** - The Law No. 212 fund reports revenue sources and the expenditures for the construction of the Rosendo Matienzo Public Square. The project was financed with funds received through the 212 State Law of 2011 to be received through the Puerto Rico Department of Transportation (“DTOP”). Project was financed through loans from the general fund. Management believes the amount due from DTOP collectible and is still making collection efforts.
- **Debt Service Fund** - The debt service fund accounts for the resources of two individual funds including the “Fondo 10 - CAE Redemption Fund” (a special surtax redemption fund established by the CRIM with GDB which accounts for the 2% of property taxes collected by the CRIM and the IVU Municipal Redemption Fund (.2% of the .5% from sales and use taxes deposited in the Municipal Administration fund of GDB to finance loans to Municipalities). There were no significant variances in revenues and expenditures with respect to 2014. The Fund reported other financing uses of \$1,563,457 representing transfers of funds to the general fund for (1) excess funds of CRIM Property Taxes Fund (CAE) for \$401,607 and (2) excess funds of IVU Municipal Redemption Fund for \$1,161,850. As a result, the fund balance decreased from \$2,977,865 in 2014 to \$2,206,919. This excess of funds may be transferred to the Municipality’s general fund as authorized by Municipal regulations.

Proprietary funds - The Municipality’s proprietary funds provide the same type of information found in the government-wide statements but in more detail. The net position of *Municipal Enterprise Centro de Diagnóstico y Tratamiento* (“ME CDT”) at the end of the fiscal year amounted to \$103,533. Revenues of the ME CDT consist mainly of charges for services – contract fees paid to a private medical provider and an operating grant transferred from the Municipality. Expenses consist of professional services (grant of funds transferred to medical provider) and other operational expenses. ME CDT reported a positive change in net position of \$103,533 in the statement of revenues, expenses and changes in net position. The Municipal Enterprise started operations in October 2014.

GENERAL FUND BUDGETARY HIGHLIGHTS

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1991, as amended. In order to demonstrate compliance with budget regulations and accounting standards, the Municipality presents a budgetary comparison schedule of the general fund as required supplementary information. This schedule is prepared under a budgetary basis of accounting, which is different from accounting principles generally accepted in the United States of America (“US GAAP”). Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The general fund original budget for the fiscal year 2014-2015 presented an increase of \$159,711 or 2% with respect to the prior year original budget. Budget revisions during 2015 amounted to \$735,578 for a total revised budget of

**COMMONWEALTH OF PUERTO RICO
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\$10,086,462. Actual revenues exceeded revised budgeted revenues by \$159,220 (net). The Municipality also reported a positive variance of \$83,190 between revised budgeted appropriations and actual expenditures. Actual revenues exceeded actual expenditures by \$242,410.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets, governmental activities: At the end of the fiscal year, the Municipality has invested \$47,219,350 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land, furniture, works of art and equipment. This amount represents a net increase of \$136,543 over the prior year. The following **TABLE 4** discloses the capital assets balances as of June 30, 2015 and 2014:

TABLE 4

	<i>Capital Assets, net</i>	
	<i>As of June 30,</i>	
	Governmental Activities	
	2015	2014
Nondepreciable assets:		
Land	\$ 10,462,413	\$ 10,462,413
Construction in progress	1,337,372	3,786,710
Depreciable assets (net):		
Buildings and buildings improvements	23,732,586	21,013,619
Infrastructure	7,356,653	7,360,868
Infrastructure improvements	3,278,793	3,286,849
Equipment	333,441	341,903
Furniture	36,649	9,414
Works of Art	654	654
Computers	183,383	73,451
Vehicles	497,406	746,926
Total:	\$ 47,219,350	\$ 47,082,807

The Municipality's major capital projects that were still in construction and the related cost as of June 30, 2015 are as follows:

- "Remodelación Centro de Arte y Cultura" with \$836,144 costs incurred as of year-end. Project is currently financed through the general fund and \$2,785,000 special obligation bond.
- "Parque Recreativo Barrio Sabana" with \$148,215 costs incurred as of year-end. Project is currently financed through the general fund and Commonwealth Legislature Resolutions.

During the fiscal year 2014-2015 the Municipality:

- Completed and transferred various projects to building improvements including: "Facilidades Deportivas Brisas

**COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

del Mar" amounting \$1,960,758 and "Cancha Juan Martín" amounting \$475,216.

- Received as a donation the facilities of the diagnostic and treatment center located in Luquillo from the Puerto Rico Department of Health through Commonwealth's Legislature Resolution Number 87 of August 11, 2014. The facilities estimated cost amounted to \$700,000.
- Completed infrastructure projects for a total amount of \$567,454.

Capital assets, business-type activities: The *Municipal Enterprise Centro de Diagnóstico y Tratamiento* operates in facilities owned by the Municipality, in exchange of a \$1 rent. As discussed earlier, the Municipality received as a donation the facilities of the diagnostic and treatment center from the Puerto Rico Department of Health. Equipment, furniture and a vehicle used in the facilities are also property of the Municipality.

More detailed information about the Municipality's capital assets is presented in Note E to the financial statements.

Long-term debt

Governmental activities - Long-term debt of governmental activities increased 111% to \$41,302,241 with respect to 2014. This significant change primarily arises from the implementation of *GASB Statement No. 68* "Accounting and Financial Reporting for Pensions—an amendment of *GASB Statement No. 27*" and *GASB Statement No. 71* "Pension Transition for Contributions Made Subsequent to the Measurement Date". The Municipality, as a cost-sharing employer, reported its proportionate share of the pension plan's resulting net pension liability from Statement No. 67 based on their respective individual proportion to the collective net pension liability of all the governments participating. No new debt was issued during 2015 as access to markets and the participation of the Municipality in the bond market has been delayed waiting for the credit rating of the Commonwealth and its instrumentalities to improve or for more favorable market conditions. The following **TABLE 5** is a summary of the Municipality's outstanding debt as of June 30, 2015 and 2014:

TABLE 5

<i>Outstanding Long-term debt</i>		
<i>Fiscal years ended June 30,</i>		
	Governmental Activities	
	2015	2014
General and special obligation bonds and notes	\$ 16,001,000	\$ 16,838,000
Payable to CRIM:		
Law No. 42	450,061	464,029
Financing of delinquent accounts	155,589	164,740
Property tax advances	33,785	-
Compensated absences	1,205,790	1,280,691
Christmas bonus payable	143,780	141,876
Payable To PREPA	285,063	716,685
Judgments and claims	288,000	-
Net pension liability	22,739,173	-
Total:	\$ 41,302,241	\$ 19,606,021

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2015**

The Municipality implemented GASB Statement No. 68 effective July 1, 2014. The 2014 amounts presented have not been restated to reflect the implementation of GASB Statements 68 and 71.

Business-type activities – the *The Municipal Enterprise Centro de Diagnóstico y Tratamiento* have no long-term debt outstanding as of June 30, 2015.

More detailed information about the Municipality's long-term liabilities is presented in Note F of the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Commonwealth of Puerto Rico and its instrumentalities are currently facing a severe fiscal and liquidity crisis. Credit rating agencies have been downgrading its rating on the Commonwealth debt obligations based on, among other problems, years of deficit financing, pension underfunding, budgetary imbalance and a prolonged economic recession. These downgrades may have a significant impact in the economic environment of Puerto Rico and the Commonwealth Government, its instrumentalities and the municipalities in critical areas such as access to markets and liquidity for the current fiscal year and thereafter. Therefore, the participation of the Municipality in the bond market has been delayed waiting for the credit rating of the Commonwealth and its instrumentalities to improve or for more favorable market conditions.

On April 6, 2016 the Commonwealth approved Act 21-2016 known as the *Puerto Rico Emergency Moratorium and Financial Rehabilitation Act* ("Act No. 21") (as amended) to declare a moratorium on debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth and certain of its instrumentalities. On April 8, 2016 the Commonwealth's Governor signed Executive Order No. 2016-010 ("EO No. 2016-010") declaring the Bank in state of emergency pursuant to Act No. 21. EO No. 2016-010 implemented a regulatory framework governing GDB's operations and liquidity by prohibiting loan disbursements by GDB and establishing a procedure with respect to withdrawals, payments and transfer requests with respect of funds held on deposits at GDB by the Commonwealth and its instrumentalities, including the Municipalities. The withdrawal, payment and transfer of funds held on deposit at GDB are restricted to those reasonable and necessary to ensure the provision of essential services and the GDB is authorized to establish weekly limits on the aggregate amount of such disbursements.

The Municipality is a participating employer in a retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). The ERS is a mature retirement system with a significant retiree population. Based on the statutory funding requirements, the annual benefit payments and administrative expenses paid by ERS were significantly larger than the member's and employers' contributions to the ERS. This matter, among other factors, caused the ERS to have liquidity and solvency problems. The Commonwealth approved Act No. 3 of 2013 and Act No. 32 of 2013 which amend the provisions of the different benefits structures under the ERS and established increasing and additional contributions to the ERS including:

- All participants are required to contribute 10% of gross salary.
- The Municipality contributed 13.275% of gross salary for fiscal year 2014-2015 with an additional 1% for the next fiscal year and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.
- The Municipality is subject to an Additional Uniform Contribution ("AUC"). The ERS will determine the amount of AUC to be billed and paid by each employer during each fiscal year.
- Special laws and pensioner additional benefits are funded on a pay-as-you-go basis and billed by ERS to

**COMMONWEALTH OF PUERTO RICO
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YEAR ENDED JUNE 30, 2015**

the Municipality at the beginning of each fiscal year. The invoice includes a supplemental contribution of \$2,000 per pensioner to finance the Additional Benefits Program.

These additional contributions have an incremental and significant effect on pension related costs to the Municipality, which will be financed with general fund resources.

If these increasing contributions are not paid in full on an annual basis by the Commonwealth, its instrumentalities and the Municipalities, the ERS will continue to become rapidly defunded and gross assets will be exhausted which will cause the ERS to become insolvent by the fiscal year 2018. This situation will cause ERS to operate as a pay-as-you-go basis, which means that it would be unable to pay benefits in excess of contributions, unless the Commonwealth and the Municipalities provides the necessary funding.

The Municipality's officials considered certain factors when establishing the fiscal year's 2014-2015 budget. One of these factors is the economy. Among economic areas considered are the estimates for the growth or decline in population, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate at June 2015 stands at 15.8%, and the Commonwealth rate stands at 12.8%.

For the year 2015-2016, the Municipality applied a conservative approach in the development of budget estimates. Amount available for appropriations in the General Fund are \$9,349,625 with approximately no variance respect to prior year estimates. Budgeted expenditures are expected to rise according to the increase of budgeted revenues. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase modestly by the close of the 2015-2016 fiscal year. In addition to the general fund estimated budget, the Municipality plans to submit to the Federal and Commonwealth government fund proposals for welfare and community development as well as permanent capital improvements and public works.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have any questions about this report or need any additional information contact the Finance Department at the Municipality of Luquillo at P.O. Box 1012, Luquillo, Puerto Rico 00773.

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF NET POSITION
JUNE 30, 2015**

	Primary Government		
	Governmental Activities	Business-type Activities	Total
<u>Assets</u>			
Cash and cash equivalents	\$ 1,004,513	\$ 61,548	\$ 1,066,061
Cash with fiscal agent	3,472,251	-	3,472,251
Receivables, net:			
Municipal license taxes	2,429	-	2,429
Others	345,322	41,985	387,307
Due from:			
Commonwealth Government	949,319	-	949,319
Federal Government	649,895	-	649,895
Restricted assets:			
Cash and cash equivalents	1,616,019	-	1,616,019
Cash with fiscal agent	5,869,131	-	5,869,131
Other assets	25,773	-	25,773
Capital assets:			
Land and construction in progress	11,799,785	-	11,799,785
Other capital assets, net	35,419,565	-	35,419,565
Total capital assets, net	<u>47,219,350</u>	<u>-</u>	<u>47,219,350</u>
Total assets	<u>61,154,002</u>	<u>103,533</u>	<u>61,257,535</u>
<u>Deferred outflows of resources</u>			
Deferred outflows related to pensions	<u>1,338,060</u>	<u>-</u>	<u>1,338,060</u>
Total deferred outflows of resources	<u>1,338,060</u>	<u>-</u>	<u>1,338,060</u>
<u>Liabilities</u>			
Accounts payable and accrued liabilities	1,370,307	-	1,370,307
Interest payable	347,796	-	347,796
Due to:			
Commonwealth Government	84,397	-	84,397
Unearned revenues:			
Intergovernmental-Federal grants	235,710	-	235,710
Long-term liabilities:			
Due within one year	1,680,202	-	1,680,202
Due in more than one year	39,622,039	-	39,622,039
Total liabilities	<u>43,340,451</u>	<u>-</u>	<u>43,340,451</u>
<u>Deferred inflows of resources</u>			
Municipal License taxes received in advance	531,306	-	531,306
Deferred inflows related to pensions	181,968	-	181,968
Total deferred inflows of resources	<u>713,274</u>	<u>-</u>	<u>713,274</u>
<u>Net position</u>			
Net investment in capital assets	33,472,946	-	33,472,946
Restricted for:			
Debt service	3,243,298	-	3,243,298
Capital Projects	1,650,516	-	1,650,516
Other specified purposes	512,399	-	512,399
Unrestricted	(20,440,822)	103,533	(20,337,289)
Total net position	<u>\$ 18,438,337</u>	<u>\$ 103,533</u>	<u>\$ 18,541,870</u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2015**

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Position		
		Fees, Fines and Charges for services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		
					Governmental Activities	Business-type Activities	Total
Governmental activities:							
Governmental Activities:							
General government	\$ 7,652,150	\$ 1,204,936	\$ 294,767	\$ -	\$ (6,152,447)	\$ -	\$ (6,152,447)
Public works and sanitation	3,471,707	-	125,000	496,268	(2,850,439)	-	(2,850,439)
Public safety	296,916	-	-	-	(296,916)	-	(296,916)
Culture and recreation	784,808	-	22,120	-	(762,688)	-	(762,688)
Health	260,004	-	-	-	(260,004)	-	(260,004)
Housing, welfare and community development	3,275,018	-	2,514,980	-	(760,038)	-	(760,038)
Education	20,241	-	-	-	(20,241)	-	(20,241)
Interest on long-term debt	694,938	-	-	-	(694,938)	-	(694,938)
Total governmental activities	\$ 16,455,782	\$ 1,204,936	\$ 2,956,867	\$ 496,268	(11,797,711)	-	(11,797,711)
Business-type activities:							
M.E. Centro de Diagnostico y Tratamiento	403,321	36,317	-	-	-	(367,004)	(367,004)
Total business-type activities	403,321	36,317	-	-	-	(367,004)	(367,004)
Total primary government	\$ 16,859,103	\$ 1,241,253	\$ 2,956,867	\$ 496,268	(11,797,711)	(367,004)	(12,164,715)
General revenues :							
Taxes:							
Property taxes					3,881,262	-	3,881,262
Municipal license taxes					847,246	-	847,246
Sales and use taxes					1,639,039	-	1,639,039
Grants contributions not restricted to specific programs					4,939,317	-	4,939,317
Interest					191,719	-	191,719
Other					898,762	-	898,762
Transfers					(470,537)	470,537	-
Total general revenues:					11,926,808	470,537	12,397,345
Change in net position					129,097	103,533	232,630
Net position at beginning of year, as restated					18,309,240	-	18,309,240
Net position at end of year					\$ 18,438,337	\$ 103,533	\$ 18,541,870

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2015**

	<u>Major Funds</u>						<u>Total Governmental Funds</u>
	<u>General</u>	<u>Community Development Block Grant Program</u>	<u>Bonds and Notes Issuance</u>	<u>Law No. 212</u>	<u>Debt Service</u>	<u>Other Governmental Funds</u>	
Assets							
Cash and cash equivalents	\$ 1,004,513	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,004,513
Cash with fiscal agent	3,472,251	-	-	-	-	-	3,472,251
Receivables, net:							
License taxes	3,432	-	-	-	-	-	3,432
Other	-	-	-	338,319	-	6,000	344,319
Due from:							
Commonwealth Government	354,456	-	-	-	314,067	280,796	949,319
Federal Government	-	182,949	-	-	-	466,946	649,895
Other funds	786,495	-	-	-	-	4,500	790,995
Restricted assets:							
Cash and cash equivalents	-	644	-	-	-	1,615,375	1,616,019
Cash with fiscal agent	-	-	2,568,994	-	3,277,027	23,110	5,869,131
Other assets	25,773	-	-	-	-	-	25,773
Total assets	<u>\$ 5,646,920</u>	<u>\$ 183,593</u>	<u>\$ 2,568,994</u>	<u>\$ 338,319</u>	<u>\$ 3,591,094</u>	<u>\$ 2,396,727</u>	<u>\$ 14,725,647</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2015

	Major Funds						Total Governmental Funds
	General	Community Development Block Grant Program	Bonds and Notes Issuance	Law No. 212	Debt Service	Other Governmental Funds	
Liabilities							
Accounts payable and accrued liabilities	\$ 548,202	\$ 146,810	\$ 194,121	\$ 3,319	\$ -	\$ 477,855	\$ 1,370,307
Matured bonds and interest payable	-	-	-	-	1,197,467	-	1,197,467
Due to:							
Commonwealth Government	84,397	-	-	-	-	-	84,397
Other funds	-	36,504	-	334,999	-	419,492	790,995
Unearned revenues:							
Intergovernmental - Federal grants	-	-	-	-	-	235,709	235,709
Total liabilities	632,599	183,314	194,121	338,318	1,197,467	1,133,056	3,678,875
Deferred inflows of resources							
Municipal License taxes received in advance	531,306	-	-	-	-	-	531,306
Unavailable revenues:							
Property taxes	-	-	-	-	158,354	-	158,354
Sales and use taxes	33,448	-	-	-	28,354	-	61,802
Commonwealth Government	321,008	-	-	338,319	-	238,641	897,968
Federal grants	-	161,851	-	-	-	37,866	199,717
Total deferred inflows of resources	885,762	161,851	-	338,319	186,708	276,507	1,849,147
Fund balances (deficits)							
Restricted	-	-	2,374,873	-	2,206,919	1,799,634	6,381,426
Assigned	1,919,294	-	-	-	-	-	1,919,294
Unassigned	2,209,265	(161,572)	-	(338,318)	-	(812,470)	896,905
Total fund balances (deficit)	4,128,559	(161,572)	2,374,873	(338,318)	2,206,919	987,164	9,197,625
Total liabilities, deferred inflows of resources and fund balances (deficit)	\$ 5,646,920	\$ 183,593	\$ 2,568,994	\$ 338,319	\$ 3,591,094	\$ 2,396,727	\$ 14,725,647

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET POSITION
JUNE 30, 2015**

Total fund balances - governmental funds		\$ 9,197,625
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the governmental funds balance sheet		47,219,350
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:		
Christmas bonus reimbursement	\$ 35,945	
Property taxes- Debt Service Fund	158,354	
Sales and use taxes- Debt Service Fund	28,354	
Sales and use taxes- General Fund	33,448	
P.R. Department of Labor - Law No. 52	232,641	
P.R. Electric Power Authority (PREPA)	285,063	
P.R. Department of Transportation and Public Works (DTOP)	338,319	
Other	6,000	1,118,124
Due from Federal Government:		
Federal grant - CDBG	161,851	
Federal grant - 21st Century	37,866	199,717
Deferred outflows of resources related to pensions not recognized in the governmental funds' balance sheet:		1,338,060
Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds		(330)
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the funds:		
General obligation bonds and notes	(15,151,000)	
CRIM property tax liquidation's liability	(33,785)	
Note payable to CRIM-Law No. 146	(155,589)	
Note payable to CRIM-Law No. 42	(450,061)	
Net pension liability	(22,739,173)	
Compensated absences	(1,205,790)	
Christmas bonus	(143,780)	
Judgments and claims debt	(288,000)	
Debt payable to PREPA	(285,063)	(40,452,241)
Deferred inflows of resources related to pensions not recognized in the governmental funds balance sheet:		(181,968)
Net position of governmental activities:		\$ 18,438,337

The accompanying notes are an integral part of these statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES (DEFICIT) -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2015**

	Major Funds					Other Governmental Funds	Total Governmental Funds
	General	Community Development Block Grant Program	Bonds and Notes Issuance	Law No. 212	Debt Service		
Revenues:							
Taxes:							
Property taxes	\$ 2,516,216	\$ -	\$ -	\$ -	\$ 1,405,478	\$ -	\$ 3,921,694
Municipal license taxes	847,246	-	-	-	-	-	847,246
Sales and use taxes	640,552	-	-	-	936,685	-	1,577,237
Intergovernmental:							
Commonwealth Government	4,401,827	-	-	-	-	1,353,410	5,755,237
Federal Government	-	629,256	-	-	-	2,141,638	2,770,894
Fees, fines and charges for services	1,636,558	-	-	-	-	-	1,636,558
Interest	29,052	-	160,202	-	2,431	34	191,719
Other	120,844	-	-	-	-	28,399	149,243
Total revenues	10,192,295	629,256	160,202	-	2,344,594	3,523,481	16,849,828

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES (DEFICIT) -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2015

	Major Funds					Other Governmental Funds	Total Governmental Funds
	General	Community Development Block Grant Program	Bonds and Notes Issuance	Law No. 212	Debt Service		
Expenditures:							
Current:							
General government	6,687,057	-	-	-	-	183,413	6,870,470
Public works and sanitation	2,521,875	-	8,487	-	-	273,309	2,803,671
Public Safety	206,794	-	-	-	-	20	206,814
Culture and recreation	276,724	-	1,849	-	-	18,661	297,234
Health	161,939	-	-	-	-	-	161,939
Welfare and community development	750,018	227,601	-	-	-	2,023,930	3,001,549
Education	-	-	-	-	-	20	20
Capital outlays	521,155	229,074	20,715	-	-	532,817	1,303,761
Debt Service:							
Principal	-	-	-	-	857,000	-	857,000
Interest	-	-	-	-	695,083	-	695,083
Total expenditures	11,125,562	456,675	31,051	-	1,552,083	3,032,170	16,197,541
Excess (deficiency) of revenues over expenditures	(933,267)	172,581	129,151	-	792,511	491,311	652,287
Other financing sources (uses):							
Transfers in	1,862,819	-	-	-	-	-	1,862,819
Transfers (out)	(115,000)	-	(160,202)	-	(1,563,457)	(494,697)	(2,333,356)
Total other financing resources (uses)	1,747,819	-	(160,202)	-	(1,563,457)	(494,697)	(470,537)
Net change in fund balances (deficit)	814,552	172,581	(31,051)	-	(770,946)	(3,386)	181,750
Fund balances (deficit) at beginning of year, as restated	3,314,007	(334,153)	2,405,924	(338,318)	2,977,865	990,550	9,015,875
Fund balances (deficit) at end of year	\$ 4,128,559	\$ (161,572)	\$ 2,374,873	\$ (338,318)	\$ 2,206,919	\$ 987,164	\$ 9,197,625

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
BALANCES (DEFICIT) OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2015**

Net change in fund balances (deficit) - total governmental funds:		\$ 181,750
Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:		
Expenditures for capital assets	\$ 1,303,761	
Less: current year depreciation	<u>(1,707,082)</u>	(403,321)
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net position differs from the change in fund balance by the cost of the disposed asset:		
		(160,136)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Christmas bonus reimbursement	35,945	
Property taxes- Debt Service Fund	158,354	
Sales and use taxes- General Fund	33,448	
Sales and use taxes- Debt Service Fund	28,355	
P.R. Department of Labor - Law No. 52	127,039	
Federal grant - CDBG	65,913	
Federal grant - 21St. Century	37,866	
Donated assets	<u>700,000</u>	1,186,920
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
Christmas bonus reimbursement	70,938	
Property taxes-General Fund	165,001	
P.R. Electric Power Authority (PREPA)	431,622	
P.R. Department of Labor - Law No. 52	91,289	
Federal grant - CDBG	<u>238,214</u>	(997,064)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)	20,000	
Municipality's contributions to the pension plan in current year	<u>561,911</u>	581,911
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	837,000	
Other long term liabilities	<u>672,725</u>	1,509,725
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:		
Compensated absences	(1,207)	
CRIM property tax liquidation's liability	(33,785)	
Christmas Bonus	(143,780)	
Judgments and Claims	(288,000)	
Pension	(1,304,058)	
Accrued interest (net change)	<u>142</u>	(1,770,688)
Change in net position of governmental activities:		<u>\$ 129,097</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF NET POSITION - PROPRIETARY FUND
JUNE 30, 2015

	Business-type Activities - Enterprise Fund
	Municipal Enterprise Centro Diagnóstico y Tratamiento
Assets	
Current assets:	
Cash	\$ 61,548
Accounts receivable	41,985
Total current assets	103,533
Total assets	103,533
Liabilities and net position	
Net position	
Unrestricted (deficit)	103,533
Total net position	\$ 103,533

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET
POSITION -
PROPRIETARY FUND
NINE MONTHS ENDED JUNE 30, 2015**

	Business-type Activities - Enterprise Fund Municipal Enterprise Centro Diagnóstico y
Operating revenues	
Fees and charges for services	\$ 35,919
Other	398
Total operating revenues	36,317
Operating expenses	
Professional services	399,644
Repairs and maintenance	3,616
Other	61
Total operating expenses	403,321
Operating income (loss)	(367,004)
Transfers from other funds	470,537
Change in net position	103,533
Net position at beginning of year	-
Net position at end of year	\$ 103,533

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
STATEMENT OF CASH FLOWS -
PROPRIETARY FUND
NINE MONTHS ENDED JUNE 30, 2015**

	Business-type Activities - Enterprise Fund Municipal Enterprise Centro Diagnóstico y Tratamiento
Cash flows from operating activities:	
Cash received from fees and charges for services	\$ 2,916
Other cash receipts	398
Professional services	(408,626)
Repairs and maintenance	(3,616)
Other cash disbursements	(61)
Net cash used in operating activities	(408,989)
Cash flows from noncapital financing activities:	
Transfers from other funds for operating subsidies	470,537
Loan received from the Municipality	180,000
Loan repayment to the Municipality	(180,000)
Net cash provided by noncapital and financing activities	470,537
Net increase in cash	61,548
Cash at beginning of year	-
Cash at end of year	\$ 61,548
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities	
Operating Income	\$ 103,533
Adjustments to reconcile change in net position to net cash provided by operating activities:	
Increase (decrease) in:	
Accounts receivable	(41,985)
Total Adjustments	(41,985)
Net cash provided by operating activities	\$ 61,548

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Luquillo was founded in 1797. The Municipality is governed by the executive and the legislative branch elected for a four-year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of fourteen (14) members of the Municipal Legislature. The Municipality engages in comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of the Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

1. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality of Luquillo (the primary government) and component units. A primary government is any state government or general purpose local government (a municipality). All funds, organizations, institutions, agencies, departments, and offices that are not legally separate are, for financial reporting purposes, part of a primary government. If an organization is part of a primary government, its financial data should be included with the financial data of the primary government. Component units are legally separate organizations for which the primary government is financially accountable or organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. A component unit may be a governmental organization, a nonprofit corporation or a for-profit corporation.

The following circumstances set forth a primary government's financial accountability for a legally separate organization:

- a. The primary government appoints a voting majority of the entity's governing body, and either:
 - A financial benefit/ burden exists between the primary government and the entity or
 - The primary government can impose its will on the entity.
- b. The entity is fiscally dependent on the primary government and there is a financial benefit/burden between the primary government and the entity.

In addition, as described above, it would be necessary to include other organizations as a component unit if the exclusion would cause the primary government's financial statements to be misleading or incomplete. Organizations that are legally separate, tax-exempt entities and that meet all of the following criteria should be *discretely* presented as component units:

- a. 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.
- b. 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

- c. 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.

Professional judgment should be applied in determining whether the relationship between a primary government and other organizations for which the primary government is not financially accountable and that do not meet the above criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

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:

- a. 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 between the primary government and the entity or
 - Management of the primary government has operational responsibility for the primary government.
- b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government.
- c. The component unit's debt is expected to be paid by the primary government.

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*"). As discussed earlier, other legally separate, tax-exempt organizations that meet the applicable criteria should be included as *discretely component units*.

Based on the above criteria the following component unit, while legally separate from the Municipality, meets the blending criteria to be reported as part of the primary government financial statements:

Municipal Enterprise "Centro de Diagnóstico y Tratamiento" ("ME CDT") – The ME CDT is a for-profit legally separated corporation organized pursuant Article 2.004 (u) of the Autonomous Municipalities Act No. 81 of 1991 as amended. It was created as a Municipal Enterprise through the Municipal Legislature Ordinance No. 5 Series 2013-2014 to provide health services to the general public. As required by law, it is governed by a Board of Directors composed of five (5) members (all Municipal officer's members of the executive branch) appointed by the Mayor (except for the Finance Director whose membership is compulsory). The Municipality appoints a voting majority of the ME CDT's board of directors, has the ability to impose its will on the organization and provides significant financial support to finance its operating expenses. ME CDT started operations in October 2014 and signed a collaborative agreement with the Municipality of Luquillo to administer and operate the facilities of the diagnostic and treatment center owned by the Municipality, in exchange of a \$1 rent. Following that date, ME CDT sub-contracted with a private medical provider the administration and operation of the ME CDT's emergency room and the provision of other medical services to the general public. The provider will pay back to the ME CDT 30% of amount collected on medical services rendered by the provider. The ME CDT's financial statements are blended into

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

the Municipality's financial statements as an enterprise fund since (1) the governing body of ME CDT is in substance the same of the Municipality and (2) the significant financial support the Municipality provides to ME CDT to finance its operating expenses.

The ME CDT issued separate compiled financial statements as of and for the nine months ended June 30, 2015 which can be obtained directly by contacting its administrative office at P.O. Box 1012 Luquillo, P.R. 00773.

2. Basis of presentation, measurement focus and basis of accounting

The financial report of the Municipality consists of the Management's Discussion and Analysis (MD&A), basic financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management's Discussion and Analysis

This consists of a narrative that introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Government-wide statements

The government-wide statements consist of a Statement of Net Position and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which refers to the reporting of all of the net position available to the governmental unit for the purpose of providing goods and services to the public. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Position presents all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference reported as net position. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Direct expenses are those that are clearly identifiable with a specific function. As a policy, indirect expenses are not allocated in the Statement of Activities. Program revenues must be directly associated with the function.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes are considered imposed non-exchange transactions since they are based on assessments imposed by the Municipality that are not based on exchange transactions. Property taxes are recognized as revenues in the year for which the taxes are levied. Municipal license taxes and sales and use taxes are considered derived tax revenues since they are taxes imposed by the Municipality based on exchange transactions. Municipal license taxes are recorded as revenues in the period the Municipality has an enforceable legal claim and time requirements are met; sales and use taxes are recognized as revenues in the period when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met. For certain expenditure-driven grants, revenue is recognized after allowable expenditures are incurred.

The Municipality reports a deferred inflow of resources for unearned revenues in the government-wide statements. Unearned revenues arise when (1) resources received in advance of an exchange transaction, (2) resources received in advance in relation to a derived tax revenue, and (3) resources received in advance related to voluntary non-exchange transactions when eligibility requirements other than time requirements have not been met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, after related exchange transactions occur or applicable eligibility requirements are met, the deferred inflow of resources for unearned revenues is removed from the statement of net position and the revenue is recognized.

Governmental Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which is considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, deferred outflows, liabilities, deferred inflows, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official's criteria if the fund is particularly important to financial statement users. The Municipality reports the following major governmental funds:

General Fund: This is the operating fund of the Municipality and is used to account for and report all financial resources not accounted for and reported in another fund.

Community Development Block Grant Program (CDBG) Fund: CDBG fund is used to account for and report revenue sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. CDBG funds are received through the Office of Commissioner of Municipal Affairs ("OCAM"), a Commonwealth's governmental agency.

Bonds and Notes Issuance Fund: This fund is used to account for and report financial resources from bond proceeds and notes issuances which are restricted for acquisition or construction of capital assets. This fund

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

reports transactions of individual funds of Bonds and Notes issued through GDB.

Law No. 212 Fund: This fund is used to account for and report revenue sources and the expenditures for the construction of the Rosendo Matienzo Public Square. The project was financed with funds received through the 212 State Law of 2011.

Debt Service Fund: this fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditures for the payment of principal and interest of the Municipality's general and aspecial obligation bonds and notes. This fund accounts for the resources of three individual funds including "Fondo 10 - CAE Redemption Fund" (a special surtax redemption fund established by the CRIM with GDB which accounts for the 2% of property taxes collected by the CRIM) and the IVU Municipal Redemption Fund (.2% of the .5% from sales and use taxes deposited in the Municipal Administration fund of GDB to finance loans to Municipalities).

The Municipality also reports nonmajor governmental funds in a single column, which includes the following:

Special Revenue Funds: this fund is used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specific purposes other than debt service or capital projects. The core revenue source of the fund must represent a substantial portion of the fund's total inflows. The limitation on spending (specific purpose) may be imposed by external parties (creditors, grantors, contributors, other governments), by constitutional provisions, by enabling legislation or by action taken by the government's own highest level of decision-making authority.

Capital Project Funds: this fund is used to account for and report financial resources that are restricted, committed or assigned to expenditures for capital outlays, including the acquisition or construction of capital facilities and other capital projects. Typically, the fund is not used for routine or minor capital outlays (equipment, vehicles, furniture, among others) which are reported instead in the fund from which financial resources were expended. Rather, the fund is used primarily for major projects and acquisitions financed with borrowed or contributed resources. The use of a capital project fund frequently is required by debt covenants, grant contracts, law or regulation.

The governmental fund financial statements are accounted for using the current financial resources measurement focus and the modified-accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. both measurable and available). Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Revenues susceptible to accrual include property taxes, recognized as revenues in the year for which the taxes are levied; municipal license taxes, recognized in the period the Municipality has an enforceable legal claim and time requirements are met; and sales and use taxes, recognized when the underlying exchange has occurred, and interest. In applying the susceptible to accrual concept to intergovernmental revenues, revenues are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met and revenue becomes available. There are, however, essentially two types of these revenues. In the first case, on expenditure-driven grants, monies must be expended on the specific project or purpose (eligibility requirement),

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

before any amounts are paid to the Municipality. Revenue is, therefore, recognized as expenditures are incurred to the extent available. In the other cases, monies are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. In these cases, revenues are recognized as the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports a deferred inflow of resources for unearned revenues in the governmental funds statements. Unearned revenues arise when (1) resources received in advance of an exchange transaction, (2) resources received in advance in relation to a derived tax revenue, and (3) resources received in advance related to voluntary non-exchange transactions when eligibility requirements other than time requirements have not been met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, after related exchange transactions occur or applicable eligibility requirements are met, the deferred inflow of resources for unearned revenues is removed from the balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred as under accrual basis of accounting. Certain exceptions to this fundamental concept include the following: (1) payments of principal and interest on general long-term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) and (2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements, the expense and related accrual liability for long-term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, a reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Proprietary Funds Statements

The proprietary fund financial statements are accounted for using the economic resources measurement focus and the accrual basis of accounting, as the business-type activities in the government-wide financial statements. Under this method of accounting, revenues are recorded when earned, independently when are collected, and expenses are recorded when incurred, independently when are paid. Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the proprietary funds are charges to customers for services. Operating expenses for the funds include the cost of operations and maintenance and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The proprietary fund statements include a Statement of Net Position, a Statement of Revenues, Expenditures and Changes in Net Position (with one for each major enterprise fund and one column combining all non-major enterprise funds) and a Statement of Cash Flows.

The Municipality's proprietary funds consist of one enterprise fund. Enterprise funds are used to account for

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

operations that are financed and operated in a manner similar to private business enterprises where the intent is
NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

that the cost of providing goods and services be financed or recovered primarily through user charges. Major enterprise funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenses or based on the Municipality's official's criteria if the fund is particularly important to financial statement users. The Municipality reports the following major enterprise fund:

Municipal Enterprise "Centro de Diagnóstico y Tratamiento" Fund: This fund, a blended component unit, is used to account for the activities of the *Municipal Enterprise "Centro de Diagnóstico y Tratamiento" ("ME CDT")*. ME CDT was created as a Municipal Enterprise to provide health services to the general public. The organization finances its operations through a 30% commission fee from a medical services provider and through financial support from the Municipality of Luquillo.

Notes to Financial Statements

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

Required Supplementary Information

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

3. Deposits and investments

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. Nonnegotiable certificates of deposits with original maturity of more than three months are considered time deposits as required by current standards. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law. The laws and regulations of the Commonwealth of Puerto Rico authorize the Municipality to invest 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 the Governmental Development Bank for Puerto Rico ("GDB").

4. Restricted assets

Restricted assets are liquid assets which have third-party limitations on their use. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law. Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property and sales and use tax collections retained by the Commonwealth of Puerto Rico, which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of the Bonds and Notes Issuance Fund represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB. Restricted cash with fiscal agent of the Other Governmental Funds represent the undisbursed proceeds of grants which are maintained in a cash custodian account by the GDB or a federal government agency.

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NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

5. *Receivables and due from governmental entities*

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property and sales tax revenues of current fiscal year collected by the CRIM – (CAE Redemption Fund) and GDB – (IVU Municipal Redemption Fund) on the subsequent fiscal year.

6. *Interfund transactions*

The Municipality reports inter-fund transactions as follows:

Inter-fund loans:	Represent legally advances that are representative of lending/borrowing arrangements from one fund to other fund to finance payroll, payroll taxes and other expenditures. The current portion of such transactions are referred as to either “due from/to other funds” and the noncurrent portion as “advances to/from other funds”. Amounts not expected to be collected within a reasonable period of time are reduced to the estimated realizable value and amounts not expected to be repaid are reported as “transfer-out” from the lender fund and “transfer-in” in the borrower fund.
Inter-fund transfers:	Represent legally flows of assets without equivalent flows of assets in return and without a requirement for repayment. These are reported as “transfers-out” (other financing uses) in the fund that issue the transfers and as “transfers-in” (other financing sources) in the fund receiving the transfers.
Inter-fund reimbursements:	Represent repayment from a fund responsible for particular expenditures or expenses to the fund that initially finances them.

7. *Inventories*

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the statement of net position, as management believes is not significant.

8. *Capital assets*

Capital assets reported in the governmental activities in the Statements of Net Position include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items). The Municipality defines capital assets (except for infrastructure assets) as assets that have an individual cost of \$500 or more and have a useful life of one or more years. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. All capital assets, other than land and construction in progress, are depreciated using the straight-line method over the following useful

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lives:

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

<u>Description</u>	<u>Years</u>
Buildings and building improvements	40
Infrastructure and infrastructure improvements	40
Equipment	3 to 5
Furniture and Fixtures	5
Work of Art	10
Vehicles	5

In accordance with current accounting standards, capital assets are reviewed for impairment. Impairment occurs when there is a significant decline in asset service utility due to the occurrence of a prominent event or change in circumstances affecting the asset. Current standards provide guidance for accounting and reporting for impairment and for insurance recoveries.

9. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the statement of net position, consist of general and special obligation bonds, liabilities for compensated absences, claims and judgments, net pension liability and long-term liabilities to other governmental entities. Related bond issuance costs, whenever rise, are reported as current outflows of resources in the Statement of Activities, as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

10. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness). The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment, the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported in the government-wide financial statements. A current portion is recognized representing the estimated amount to be used in the following year. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

Pursuant to Law No. 152 of August 20, 1996, effective July 1, 1997, the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

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NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

11. Judgments and claims

The liability and expense amounts for judgments and claims are recorded in the government-wide statements as incurred or when a loss is probable and the amount can be reasonably estimated. Amounts are recorded as liabilities and expenditures in the general fund when they mature (generally, when payment is due).

12. Accounting for pension costs

The Municipal employees are covered by the retirement plans administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). For purposes of measuring the net pension liability, deferred outflows of resources related to pensions, deferred inflows of resources related to pensions and pension expense, information about the pension plan's fiduciary net position and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by the plan. For this purpose, plan member contributions are recognized in the period in which the contributions are due. The Municipality's employer contributions are recognized when due and when the Municipality has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of plan. Investments are reported at fair value. In the governmental funds financial statements, pension expense is equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

13. 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 net 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.

In the statement of net position, deferred outflows / inflows of resources arise as a result of the following:

- a. The implementation of GASB Statement No. 68 "*Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*" and GASB Statement No. 71 "*Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*"
- b. Municipal license taxes ("patentes en suspenso") and voluntary non exchange transactions (grants) received in advance before time requirements are met are recorded as deferred inflows of resources. The deferred inflows of resources are recognized as inflows of resources (revenues) in the period when time requirements are met.

In the governmental funds, balance sheet deferred inflows of resources arise as a result of the following:

- a. Recognition of *unavailable revenue* as a result of the application of the modified-accrual basis of accounting. The governmental funds report *unavailable revenue* from three sources: property taxes, sales and use taxes and intergovernmental revenues collected or to be collected after the availability period. These amounts are recognized as an inflow of resources (revenue) in the period that the amounts become available.

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NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

- b. Municipal license taxes (“patentes en suspenso”) and voluntary non exchange transactions (grants) received in advance before time requirements are met are recorded as deferred inflows of resources. The deferred inflows of resources are recognized as inflows of resources (revenues) in the period when time requirements are met.

14. Net position

In the government-wide statements, assets plus deferred outflows of resources less liabilities and deferred inflows of resources equal net position, and should be displayed in three components: net investment in capital assets, restricted, and unrestricted, as follows:

Net investment in capital assets:

Consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. The portion of the debt or deferred inflows of resources attributable to the unspent debt proceeds is not included in the calculation of net investment in capital assets. Instead, the portion of the debt or deferred inflows of resources is included in the same net position component (restricted or unrestricted) as the unspent amount.

Restricted net position:

The restricted component of net position consists of restricted assets (subject to restrictions beyond the Municipality’s control) reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. Restrictions are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or imposed by the law through constitutional provisions or enabling legislation.

Unrestricted net position:

Unrestricted net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. Unrestricted net position is 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.

15. Net position flow assumption

Sometimes the government will fund outlays for a particular purpose from both restricted (restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the government-wide financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the government’s policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

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NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

16. Fund balances

The GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions* (“GASB No. 54”) establishes accounting and reporting standards for all governments that report governmental funds. It also establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. These classifications comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints upon the use of the resources reported. The classifications are as follows:

Nonspendable: Amounts that cannot be spent because are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

Restricted: Amounts constrained by external parties (creditors, grantors, contributors, or laws and regulations of other governments), imposed by law through constitutional provisions or by enabling legislation. Enabling legislation authorizes the Municipality to assess, levy, charge or otherwise mandate payment or resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. Legally enforceability means that the Municipality can be compelled by an external party such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation.

Committed: Amounts that can be used only for the specific purposes pursuant to constraints imposed through formal action (ordinance or resolution) by consent of the government’s highest level of decision-making authority, which in the case of the Municipality is the Mayor and the Municipal Legislature. Those committed amounts cannot be used for any other purposes unless the Mayor and the Municipal Legislature remove or change the specified use by taking the same type of action (ordinance or resolution) they employed to commit those amounts. Formal action to commit fund balance to a specific purpose should occur prior to the end of the fiscal year, but the amount, if any, which will be subject to the constraint, may be determined in the subsequent period.

Assigned: Amounts that are constrained by the Municipality’s intent to be used for specific purposes, but are neither restricted nor committed. In distinction to committed balances, the authority for making an assignment is not required to be the government’s highest level of decision-making authority, (both the Mayor and the Municipal Legislature). It is the Municipality’s policy that intent can be expressed by the Mayor, the Finance Director (the official to which the Mayor has also delegated the authority to assign amounts) or by any other official or body to which the Mayor delegates. Furthermore, the nature of the actions necessary to remove or modify an assignment is not as prescriptive as it is with committed fund balances. With the exception of the general fund, this is the residual fund balance of the classification of all governmental funds with positive fund balances. Action taken to assign fund balance may be made after year-end.

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NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Unassigned: Is the residual classification for the general fund and includes all spendable amounts not restricted, committed or assigned. The general fund is the only fund that reports a positive unassigned fund balance amount. For all other governmental funds the unassigned classification is used only to report a deficit balance resulting for the overspending for specific purposes for which amounts had been restricted, committed or assigned.

17. Fund balance flow assumptions

Sometimes the government will fund outlays for a particular purpose from both restricted and unrestricted resources (the total of committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the governmental fund financial statements a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted fund balance to have been depleted before using any of the components of unrestricted fund balance. Further, when the components of unrestricted fund balance can be used for the same purpose, committed fund balance is depleted first, followed by assigned fund balance. Unassigned fund balance is applied last.

18. Risk financing

The Municipality carries insurance coverage for professional, public responsibility, property and theft, auto and fidelity bond losses. In addition, the Municipality also obtains medical insurance for its employees. Pursuant to Act No. 63 of June 21, 2010 the municipalities of Puerto Rico procure and manage, at their own discretion, all insurance policies, including those related to the health plans provided to the municipal employees. The total cost of the annual insurance premiums is paid in full and recorded as expense by the Municipality during the fiscal year.

The Municipality obtains workers' compensation insurance through the State Insurance Fund Corporation, a component unit of the Commonwealth of Puerto Rico. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. The annual cost of insurance is allocated to the Municipality and amounts are withheld from the monthly advances of property tax and municipal equalization fund sent to the Municipality by the CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration, a component unit of the Commonwealth of Puerto Rico. The annual premium is paid per licensed motor vehicle.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Puerto Rico Department of Labor and Human Resources ("PRDOL"). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to the PRDOL on a cost-reimbursement basis.

Settled cases have not exceeded insurance coverage for any of the past three years.

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NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

19. Use of estimates

The preparation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows, liabilities, deferred inflows and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

20. Adoption of new accounting pronouncements - GASB Statements No. 68 and 71

Effective July 1, 2014, the Municipality adopted the provisions of the GASB Statement No. 68 "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27" and GASB Statement No. 71 "Pension Transition for Contributions Made Subsequent to the Measurement Date".

The primary objective of Statement No. 68 is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement replaces the requirements of *Statement No. 27, Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of *Statement No. 50, Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. This Statement will bring the effect of *GASB Statement No. 67 "Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25"* into the accounting records of the individual agencies, component units and municipalities, whose employees participate in the Retirement Systems. The Municipality, as a cost-sharing employer, reported its allocated share of the Commonwealth's resulting Net Pension Liability from Statement No. 67 based on their respective individual proportion to the collective net pension liability of all the governments participating.

The objective of Statement No. 71 is to address an issue regarding application of the transition provisions of *Statement No. 68, Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or non-employer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. This Statement amends paragraph 137 of Statement No.68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. The provisions of this Statement shall be applied simultaneously with the provisions of Statement No.68.

The implementation of these Statements have a significant impact on the Municipality's government-wide statements by restating the net position at beginning of year, recognition of deferred outflows and inflows of resources in the current year, recording of pension expense, adding new disclosure requirements and required supplementary information. Please refer to Notes F, N and Q. The implementation has no impact on the Municipality's fund statements.

21. Future adoption of accounting pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

- a. GASB Statement No. 72 "Fair Value Measurement and Application". This Statement addresses accounting and financial reporting issues related to fair value measurements. It also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2015 (fiscal year ended June 30, 2016).

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Earlier application is encouraged.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- b. **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 objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement establishes requirements for defined benefit pensions that are not within the scope of **Statement No. 68**, *"Accounting and Financial Reporting for Pensions,"* as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of **Statement 68**. The Statement also amends certain provisions of **Statement No. 67**, *"Financial Reporting for Pension Plans"*, and **Statement No. 68** for pension plans and pensions that are within their respective scopes. The requirements of this Statement that address accounting and financial reporting by employers and governmental non-employer contributing entities for pensions that are not within the scope of **Statement No. 68** are effective for financial statements for fiscal years beginning after June 15, 2016 (fiscal year ended June 30, 2017); the requirements of this Statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015 (fiscal year ended June 30, 2016); and the requirements of this Statement for pension plans that are within the scope of **Statement No. 67** or for pensions that are within the scope of **Statement No. 68** are effective for fiscal years beginning after June 15, 2015 (fiscal year ended June 30, 2016). Earlier application is encouraged.
- c. **GASB Statement No. 74** *"Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans"*. The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement replaces **Statements No. 43**, *"Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans"*, as amended, and **No. 57**, *"OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans"*.

It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in **Statement No. 25**, *"Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans"*, as amended, **Statement No. 43**, and **Statement No. 50**, *"Pension Disclosures"*. The Statement establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain non-employer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2016 (fiscal year ended June 30, 2017). Earlier application is encouraged.

- d. **GASB Statement No. 75** *"Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions"*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement replaces the requirements of **Statements No. 45**, *"Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions"*, as amended, and **No. 57**, *"OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans"*, for OPEB. **Statement No. 74**, *"Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans"*, establishes new accounting and financial reporting requirements for OPEB plans. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2017

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(fiscal year ended June 30, 2018). Earlier application is encouraged.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- c. **GASB Statement No. 76** “*The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*”. The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes **Statement No. 55**, “*The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*”. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2015 (fiscal year ended June 30, 2016) and should be applied retroactively. Earlier application is permitted.
- f. **GASB Statement No. 77** “*Tax Abatement Disclosures*”. Financial statement users need information about certain limitations on a government’s ability to raise resources. This includes limitations on revenue-raising capacity resulting from government programs that use tax abatements to induce behavior by individuals and entities that is beneficial to the government or its citizens. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this Statement defines tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens. Although many governments offer tax abatements and provide information to the public about them, they do not always provide the information necessary to assess how tax abatements affect their financial position and results of operations, including their ability to raise resources in the future. This Statement requires disclosure of tax abatement information about (1) a reporting government’s own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government’s tax revenues. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2015 (fiscal year ended June 30, 2017). Earlier application is encouraged.
- g. **GASB Statement No. 78** “*Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*”. The objective of this Statement is to address a practice issue regarding the scope and applicability of **Statement No. 68**, “*Accounting and Financial Reporting for Pensions*”. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2015 (fiscal year ended June 30, 2017). Earlier application is encouraged.
- h. **GASB Statement No. 79** “*Certain External Investment Pools and Pool Participants*”. This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it

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establishes criteria for an external investment pool to qualify for making the election to measure all of its

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

investments at amortized cost for financial reporting purposes. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2015 (fiscal year ended June 30, 2017). Earlier application is encouraged.

- i. **GASB Statement No. 80** "*Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*" The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, "The Financial Reporting Entity, as amended". This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of **Statement No. 39**, "*Determining Whether Certain Organizations Are Component Units*". The requirements of this Statement are effective for reporting periods beginning after June 15, 2016 (fiscal year ended June 30, 2017). Earlier application is encouraged.
- j. **GASB Statement No. 81** "*Irrevocable Split-Interest Agreements*" The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The requirements of this Statement are effective for reporting periods beginning after December 15, 2016 (fiscal year ended June 30, 2018). Earlier application is encouraged.
- k. **GASB Statement No. 82** "*Pension Issues-an amendment of GASB Statements No. 67, No. 68 and No. 73*". The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, No. 68 and No. 73. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016 (fiscal year ended June 30, 2017), except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier application is encouraged.

The impact that these statements will have on the Municipality's financial statements is currently under evaluation by the Municipality's management.

22. Reclassifications

Various reclassifications have been made in the accompanying basic financial statements which affect the comparability with the basic financial statements issued for previous fiscal years.

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NOTE B - DEPOSITS

Custodial credit risk – deposits, is the risk that in the event of a bank failure, the government’s deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of insurance provided by the Federal Deposit Insurance Corporation (FDIC). All securities pledged as collateral by the Municipality are held by agents designated by the Puerto Rico Secretary of Treasury but not in the Municipality’s name.

At year-end the Municipality’s bank balance of deposits in commercial banks amounting to \$2,525,102 were covered by the FDIC and by pledged securities.

Deposits in governmental banks, all of which are uninsured and uncollateralized, are exposed to custodial credit risk. At year-end, the Municipality’s bank balance in the Governmental Development Bank of Puerto Rico (“GDB”), the Commonwealth’s governmental bank, amounts to \$9,522,087 which are distributed as follows:

Description	Bank Balance Amount
Unspent proceeds of general and special obligation bonds and notes	\$ 2,568,995
Undisbursed balance of property tax collections (CAE) restricted for the repayment of the Municipality’s general and special obligation bonds and notes	2,126,927
Undisbursed balance of sales and use tax collections restricted for the repayment of the Municipality’s general and special obligation bonds and notes	1,150,100
Investment in certificates of deposits	3,472,251
Cash deposits of other Federal and Commonwealth grants	203,814
	\$ 9,522,087

The Commonwealth of Puerto Rico and its instrumentalities are currently facing a severe fiscal and liquidity crisis. Continued operational deficits and lack of access to capital markets have resulted in delays in the repayment of loans outstanding by the Commonwealth and its instrumentalities with GDB. This in turn has severely affected the GDB’s liquidity position and the ability to repay its obligations. If GDB does not obtain adequate funding from the Commonwealth for fiscal year 2017 and is not able to consummate a comprehensive debt restructuring, or to otherwise obtain additional funding or other arrangements with its creditors, GDB may not be able to continue as a going concern.

On April 6, 2016 the Commonwealth approved Act 21-2016 known as the *Puerto Rico Emergency Moratorium and Financial Rehabilitation Act* (“Act No. 21”) (as amended) to declare a moratorium on debt service payments and to delay related creditor remedies for a temporary period for the Commonwealth and certain of its instrumentalities, including GDB. Act No. 21 allows the Commonwealth’s Governor to take any and all actions that are reasonable and necessary to allow GDB to continue carrying out its operations. The temporary period set forth lasts until January 31, 2017, with a two-month extension period at the Governor’s discretion.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE B – DEPOSITS - Continued

Also, in relation to GDB, Act No. 21 allows that the Board of Directors of GDB or the Secretary of the Treasury of Puerto Rico shall have the power to recommend to the Governor the appointment of a receiver for GDB if the Board of Directors of GDB or the Secretary of the Treasury of Puerto Rico determines that: (1) GDB's assets are less than its obligations to its creditors; (2) GDB is unable to pay valid debts or obligations as they mature in the normal course of business; (3) GDB is operating in an unsafe or unsound condition to perform its statutory functions; or (4) GDB has incurred or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the Bank to become adequately capitalized. If GDB were to be placed into receivership at some point in the future, the Secretary of the Treasury would have the power to, if so requested by GDB's receiver, organize a bridge bank. The new bridge bank could assume certain of GDB's liabilities and purchase certain of its assets.

Act No. 21 also creates the Puerto Rico Fiscal Agency and Financial Advisory Authority ("the Authority") which is established as an independent public corporation and governmental instrumentality with separate legal existence, fiscal and administrative autonomy and independence from the Commonwealth. The Authority is created for the purpose of acting as fiscal agent, financial advisor and reporting agent of the Commonwealth and its public corporations, instrumentalities, commissions, authorities, municipalities and political subdivisions and to assist such entities in confronting the grave fiscal and economic emergency that the Commonwealth is currently experiencing. All fiscal agency, financial advisory and reporting functions of GDB are transferred to the Authority.

On April 8, 2016, the Commonwealth's Governor signed Executive Order No. 2016-010 ("EO No. 2016-010") declaring the Bank in state of emergency pursuant to Act No. 21. EO No. 2016-010 implemented a regulatory framework governing GDB's operations and liquidity by prohibiting loan disbursements by GDB and establishing a procedure with respect to withdrawals, payments and transfer requests with respect of funds held on deposits at GDB by the Commonwealth and its instrumentalities, including the Municipalities. The withdrawal, payment and transfer of funds held on deposit at GDB are restricted to those reasonable and necessary to ensure the provision of essential services and the GDB is authorized to establish weekly limits on the aggregate amount of such disbursements. Moreover, EO No. 2016-010 prohibits GDB depositors from printing or writing checks creditable against their accounts at GDB, unless they obtain a temporary waiver from GDB. Pursuant to EO No. 2016-010, on April 12, 2016 the Puerto Rico Department of Treasury and the Puerto Rico Office of Management and Budget issued Circular Letter No. 1300-31-16 DH \ 130-16 OGP to establish specific procedures to be followed by the Commonwealth instrumentalities and Municipalities to request the disbursement of its funds deposited in GDB.

Notwithstanding the aforementioned uncertainties, the Commonwealth has assured the Municipalities that, although they are currently suffering restrictions to access its funds deposited in GDB, such deposits in GDB will not be lost but granted for disbursements as the Municipalities follows the requirements of EO No. 2016-010 and subject to GDB's adequate liquidity levels. On January and July 2016, the GDB has met its scheduled principal and interest payments on Municipalities' general and special obligation bonds and notes pledged with special collections of property and sales and use taxes ("CAE" and "IVU"). The management of the Municipality is currently requesting funds in accordance with EO No. 2016-010 requirements in order to be disbursed in accordance with their original purposes. The ultimate resolution of these matters is currently undeterminable.

**COMMONWEALTH OF PUERTO RICO
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NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE C - DUE FROM GOVERNMENTAL ENTITIES

Amounts due from governmental entities as of June 30, 2015 follows:

	<u>Commonwealth Government</u>	<u>Federal Government</u>
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 285,063	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	35,945	-
COFIM – final settlement of 1% Municipal Transfer	33,448	-
<u>Major fund – CDBG fund:</u>		
Office of Commissioner of Municipal Affairs – CDBG	-	182,949
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – property taxes	285,713	-
GDB – final settlement of IVU Municipal Redemption Fund and FAM Municipal Development Fund	28,354	-
<u>Other governmental funds:</u>		
P.R. Department of Labor – Law #52	238,296	-
P.R. Department of Transportation	42,500	-
P.R. Department of Education – Twenty First Century Community Learning Centers	-	401,424
P.R. Office of Ombudsman Administration (OAP)-OAP-Special Program for the Aging- Title III Part B	-	65,522
	<u>\$ 949,319</u>	<u>\$ 649,895</u>

Certain amounts are recorded as deferred inflows of resources in the governmental funds statements since they are not available as required by current standards. See related Note G.

NOTE D - INTERFUND TRANSACTIONS

1. Due from/to other funds

Amounts due from/to other funds represent temporary advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	<u>Major funds:</u>	
	CDBG	\$ 36,504
	Law No. 212	330,499
	<u>Other Governmental Funds</u>	
	Section 8	4,325
	Law 52	226,114
	Title III	74,891
	Child Care (Red de Cuido)	8,601
	LRCU	5,000
	DTOP	54,562
	21th Century	45,999
		<u>786,495</u>
Other Governmental Funds	<u>Major Fund:</u>	
	Law No. 212	4,500
		<u>\$ 790,995</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE D - INTERFUND TRANSACTIONS - Continued

2. Transfers in (out)

<u>Transfer (out) Fund</u>	<u>Transfer in Funds</u>	<u>Amount</u>
Debt Service Fund	General fund	\$ 1,563,457
Bonds and Notes Issuance Fund	General fund	160,202
Other Governmental Funds	General fund	139,160
General Fund and other governmental funds	Proprietary fund	470,537
		<u>\$ 2,333,356</u>

Transfers among individual funds were made for operational purposes. Transfers include:

- a. Transfers from debt service fund to the general fund for excess funds for \$1,561,851 and interest earned on restricted cash of \$1,606.
- b. Transfers of \$160,202 from bonds and notes issuance fund to the general fund for interest on cash restricted with fiscal agent.
- c. Transfers of \$17,682 and \$121,478 from other governmental funds to the general fund of cash resulting from the closing of miscellaneous inactive funds and the transfer of Irene Storm funds, respectively.
- d. Transfers of \$470,537 from the general fund (\$115,000) and from other governmental funds (\$355,537) for operating subsidies to the enterprise fund – Municipal Enterprise Centro Diagnóstico y Tratamiento.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE E - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2015 is as follows:

	<u>Balance July 1, 2014</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2015</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 10,462,413	\$ -	\$ -	\$ 10,462,413
Construction in progress	3,786,710	736,870	3,186,208	1,337,372
Total capital assets not being depreciated:	<u>14,249,123</u>	<u>736,870</u>	<u>3,186,208</u>	<u>11,799,785</u>
Capital assets, being depreciated:				
Building	11,946,952	2,660,758	-	14,607,710
Building improvements	15,569,219	771,434	-	16,340,653
Infrastructure	10,410,484	199,420	-	10,609,904
Infrastructure improvements	5,670,809	368,034	-	6,038,843
Equipment	2,996,202	91,904	-	3,088,106
Furniture & fixtures	626,260	32,616	-	658,876
Works of art	1,960	-	-	1,960
Computer equipment	623,513	159,797	-	783,310
Vehicles, machinery and equipment	3,541,735	9,000	-	3,550,735
Total capital assets being depreciated	<u>51,387,134</u>	<u>4,292,963</u>	<u>-</u>	<u>55,680,097</u>
Less accumulated depreciation for:				
Building	5,167,592	311,388	-	5,478,980
Building improvements	1,334,960	401,837	-	1,736,797
Infrastructure	3,049,616	203,635	-	3,253,251
Infrastructure improvements	2,383,960	376,090	-	2,760,050
Equipment	2,654,299	100,365	-	2,754,664
Furniture & fixtures	616,846	5,380	-	622,226
Works of art	1,306	-	-	1,306
Computer equipment	550,062	49,867	-	599,929
Vehicles, machinery and equipment	2,794,809	258,520	-	3,053,329
Total accumulated depreciation	<u>18,553,450</u>	<u>1,707,082</u>	<u>-</u>	<u>20,260,532</u>
Total capital assets being depreciated, net	<u>32,833,684</u>	<u>2,585,881</u>	<u>-</u>	<u>35,419,565</u>
Governmental activities capital assets, net	<u>\$ 47,082,807</u>	<u>\$ 3,322,751</u>	<u>\$ 3,186,208</u>	<u>\$ 47,219,350</u>

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

Governmental activities:	
General government	\$ 301,916
Public works and sanitation	559,064
Public safety	72,552
Culture and recreation	460,017
Welfare and community development	195,248
Health	98,064
Education	20,221
Total depreciation expense, governmental activities	<u>\$ 1,707,082</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
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JUNE 30, 2015**

NOTE F - LONG-TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2015:

	Balance at July 1, 2014 as restated	Increases	Decreases	Balance at June 30, 2015	Due within one year
General, special obligations bonds and notes	\$ 16,838,000	\$ -	\$ 837,000	\$ 16,001,000	\$ 858,000
Notes payable to CRIM:					
Law No. 42	464,029	-	13,968	450,061	14,844
Financing of delinquent accounts (Law No. 146)	164,740	-	9,151	155,589	9,152
Property tax advances	-	33,785	-	33,785	-
Compensated absences	1,280,691	1,207	76,108	1,205,790	231,363
Christmas bonus	141,876	143,780	141,876	143,780	143,780
Payable to PREPA	716,685	-	431,622	285,063	285,063
Judgments and claims	-	288,000	-	288,000	138,000
Net pension liability	20,840,934	1,898,239	-	22,739,173	-
	<u>\$ 40,446,955</u>	<u>\$ 2,365,011</u>	<u>\$ 1,509,725</u>	<u>\$ 41,302,241</u>	<u>\$ 1,680,202</u>

2. General and special obligation bonds and notes

Pursuant to Act No. 64 of July 3, 1996 as amended, known as the Puerto Rico Municipal Financing Act of 1996, the Municipality is subject to a legal limitation on the total amount of indebtedness for general obligation bonds or notes, special obligation bonds, notes or instruments. The legal debt limitation of the Municipality for general obligation bonds or notes or notes in advance of general obligation bonds is equal to 10% of the total appraised value of the property located in the Municipality, as such appraisal values are determined by the CRIM. For special obligation bonds, notes or instruments the Municipality is prevented to incur in additional obligations if the annual payment of principal and interest on said bonds, notes or instruments together with the annual payment of principal and interest of the outstanding ones at that time exceeds 10% of the average recurring operating income of the Municipality of the 2 fiscal years immediately preceding the current fiscal year. These limitations are not applicable to obligations or loans whose source of repayment is the IVU Municipal Redemption Fund. Debt margin for these obligations is based on the Municipality's repayment capacity.

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2015 amount to \$16,001,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. The Municipality levies an annual additional special ad valorem tax of 2% of the assessed value of personal and real property which is collected by the CRIM and deposited in the CAE Redemption Fund at GDB. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in the IVU Municipal Redemption Fund at GDB. Debt service funds has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE F - LONG-TERM DEBT- Continued

Principal and interest payments on long term debt are made through the CAE sinking fund, except general and special obligation bonds and notes \$3,165,000, \$395,000, \$245,000, \$890,000, \$770,000 and \$2,785,000, which are made through the IVU Municipal Redemption Fund. A detail of the general and special obligation bonds and notes as of June 30, 2015 follows:

	Outstanding Amount
2003 general obligation bonds of \$4,430,000 due in annual installments of \$75,000 to \$345,000 through January 1, 2027; bearing interest at rates ranging from 4.17% to 5.31% (4.53% at June 30, 2015)	\$ 3,125,000
2008 general obligation bonds of \$2,645,000 due in annual installments of \$55,000 to \$220,000 through January 1, 2038; bearing interest at rates ranging from 1.53% to 7.50% (1.52% at June 30, 2015)	2,310,000
2008 special obligation note of \$3,165,000 due in annual installments of \$60,000 to \$270,000 through July 1, 2032; bearing interest at rates ranging from 1.53% to 7.50% (1.52% at June 30, 2015)	2,840,000
2010 general obligation notes of \$50,000 due in annual installments of \$7,000 to \$8,000 through January 1, 2017; bearing interest at a rate of 4.13%.	16,000
2011 general obligation notes of \$1,210,000 due in annual installments of \$160,000 to \$215,000 through July 1, 2017; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	600,000
2011 general obligation bonds of \$1,195,000 due in annual installments of \$55,000 to \$130,000 through July 1, 2025; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	990,000
2012 general obligation notes of \$305,000 due in annual installments of \$35,000 to \$55,000 through July 1, 2018; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	195,000
2012 general obligation bonds of \$1,510,000 due in annual installments of \$60,000 to \$160,000 through July 1, 2026; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	1,330,000
2012 special obligation note of \$395,000 due in annual installments of \$50,000 to \$70,000 through July 1, 2018; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	250,000
2012 special obligation bonds of \$245,000 due in annual installments of \$20,000 to \$35,000 through July 1, 2021; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	190,000

**COMMONWEALTH OF PUERTO RICO
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NOTES TO BASIC FINANCIAL STATEMENTS
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NOTE F - LONG-TERM DEBT- Continued

	Outstanding Amount
2012 special obligation bonds of \$890,000 due in annual installments of \$20,000 to \$85,000 through July 1, 2031; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	825,000
2012 special obligation bonds of \$770,000 due in annual installments of \$30,000 to \$85,000 through July 1, 2026; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	675,000
2012 special obligation bonds of \$2,785,000 due in annual installments of \$45,000 to \$230,000 through July 2, 2036; bearing interest at rates ranging from 6.00% to 7.50% (6.00% at June 30, 2015)	2,655,000
	\$ 16,001,000

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2015 follows:

June 30,	Principal	Interest
2016	\$ 858,000	\$ 1,112,152
2017	928,000	1,052,053
2018	995,000	987,415
2019	840,000	916,930
2020	765,000	859,359
2021-2025	4,575,000	3,435,369
2026-2030	4,195,000	1,800,452
2031-2035	2,400,000	600,750
2036-2037	445,000	50,625
Totals	\$ 16,001,000	\$ 10,815,105

Credit rating agencies have been downgrading its rating on the Commonwealth debt obligations based on, among other problems, the years of deficit financing, pension underfunding, budgetary imbalance and a prolonged economic recession. These downgrades may have a significant impact in the economic environment of Puerto Rico and the Commonwealth Government, its instrumentalities and the municipalities in critical areas such as access to markets and liquidity for the current fiscal year and thereafter. Therefore, the participation of the Municipality in the bond market has been delayed waiting for the credit rating of the Commonwealth and its instrumentalities to improve or for more favorable market conditions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE F - LONG-TERM DEBT- Continued

3. Other long-term liabilities

Note payable to CRIM (Law No. 42) – Law No. 42 of January 26, 2000 (as amended by Law No. 146 of October 11, 2001 and Law No. 172 of August 11, 2002) was enacted to authorize the CRIM to obtain a special loan in the form of a line of credit from the Governmental Development Bank of Puerto Rico (GDB) to finance a debt the municipalities of Puerto Rico owe to CRIM for excess property tax advances as of June 30, 2000. Principal and interest payments are financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico’s general fund. Amounts are retained from advances of property tax and amounts of municipal equalization fund sent to the Municipality by CRIM. Law No.42 was amended by Law no. 146 to extend from 10 to 30 years the financing period and by Law No. 172 to extend the debt period to June 30, 2001. On July 1, 2002, the Municipality entered into the financing agreement with CRIM for a total amount of \$576,023, bearing interest at 6.18% and due on July 1, 2032. Debt service requirements in future years are as follows:

**Outstanding
Amount**

\$ 450,061

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2016	\$ 14,844	\$ 27,622
2017	15,778	26,689
2018	16,769	25,697
2019	17,823	24,644
2020	18,943	23,524
2021-2025	114,134	98,198
2026-2030	154,788	57,544
2031-2032	96,982	9,184
Totals	<u>\$ 450,061</u>	<u>\$ 293,102</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE F - LONG-TERM DEBT- Continued

	Outstanding Amount
<p>Note payable to CRIM (Financing of delinquent accounts)– On March 27, 2002, the Municipality entered into a financing agreement with CRIM to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving line of credit bearing interest of 6.5% for the first five years and variable for the next twenty-five years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first five years were financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico’s general fund. Also, during the first five years, any collection from those delinquent accounts was credited to the loan principal. After the five-year period, the loan outstanding balance of \$228,834 was restructured for a twenty-five-year period. Debt service requirements in future years are as follows:</p>	<p>\$ 155,589</p>

June 30,	Principal	Interest
2016	\$ 9,152	\$ 4,125
2017	9,152	3,896
2018	9,152	3,667
2019	9,152	3,438
2020	9,152	3,208
2021-2025	45,762	12,605
2026-2030	45,762	6,875
2031-2032	18,305	1,375
Totals	\$ 155,589	\$ 39,189

	Outstanding Balance
<p>Compensated absences – includes accrued vacations, sick leave and other benefits with similar characteristics such as compensatory time; represents the Municipality’s commitment to fund such costs from future operations. The amount is paid with unrestricted funds.</p>	<p>\$ 1,205,790</p>
<p>Christmas Bonus – represents the accrued portion corresponding to the fiscal year 2015 of the Christmas bonus to be paid in December 2015.</p>	<p>\$ 143,780</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE F - LONG-TERM DEBT – Continued

	Outstanding Amount
<p>Payable to PREPA – 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. Balance outstanding as of June 30, 2015 of \$285,063 represents the unamortized excess amount of annual energy charges over CELI obligation of the fiscal year 2012-2013, which will be fully amortized during the next fiscal period. The applicable transactions of fiscal period 2013-2014 to be recognized in the current year financial statements have not been informed by PREPA. As of June 30, 2015, the outstanding amount is recognized by the Municipality as a receivable and a liability to PREPA and will be paid in fiscal year 2015-2016.</p>	<p>\$ 285,063</p>
<p>Judgments and claims – represents the estimated loss of legal cases to be paid subsequent to June 30, 2015. The final settlement amount, if any, will be paid with unrestricted funds.</p>	<p>\$ 288,000</p>
<p>Net pension liability – represents the proportional share of the collective net pension liability of all employers for benefits provided through the pension plan as of June 30, 2015 (see related Note N).</p>	<p>\$ 22,739,173</p>

NOTE G - DEFERRED INFLOWS OF RESOURCES – GOVERNMENTAL FUNDS

1. Government-wide and governmental funds:

Municipal license taxes (“patentes en suspenso”) are due on July 1 and January 1 of the subsequent fiscal year. Taxes may be paid in advance to the due dates. These taxes paid in advance are recorded as revenues or inflows of resources in the following fiscal period. Due to this time requirement, the amount paid in advance of \$531,306 is recognized as deferred inflows of resources as of June 30, 2015.

2. Governmental funds – unavailable revenues:

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 fund’s 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:

**COMMONWEALTH OF PUERTO RICO
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NOTE G - DEFERRED INFLOWS OF RESOURCES – GOVERNMENTAL FUNDS - Continued

	<u>Property Taxes</u>	<u>Sales and Use Taxes</u>	<u>Commonwealth Government Funds</u>	<u>Federal Grants</u>
<u>Major fund - General fund:</u>				
P.R. Electric Power Authority (PREPA)	\$ -	\$ -	\$ 285,063	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	-	-	35,945	-
COFIM – final settlement of 1% Municipal Transfer	-	33,448	-	-
<u>Major fund – USDHUD - CDBG fund:</u>				
U.S. Department of Housing and Urban Development – CDBG	-	-	-	161,851
<u>Major fund – Law No. 212:</u>				
Construction of Rosendo Matienzo public square	-	-	338,319	-
<u>Major fund – Debt Service fund:</u>				
Municipal Revenue Collection Center (CRIM) – property taxes	158,354	-	-	-
GDB – final settlement of IVU Municipal Redemption Fund and FAM Municipal Development Fund	-	28,354	-	-
<u>Other governmental funds:</u>				
P.R. Department of Labor – Law No. 52	-	-	232,641	-
P.R. Department of Education	-	-	-	37,866
Others	-	-	6,000	-
	<u>\$ 158,354</u>	<u>\$ 61,802</u>	<u>\$ 1,118,124</u>	<u>\$ 199,717</u>

For deferred inflows related to pensions reported in the statement of net position please refer to Note N.

NOTE H - NET INVESTMENT IN CAPITAL ASSETS

The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. The portion of the debt attributable to significant unspent proceeds should not be included in the calculation. The amount of net investment in capital assets as of June 30, 2015 is comprised of the following:

<u>Description</u>	<u>Amount</u>
Capital assets, net of accumulated depreciation	\$ 47,219,350
Outstanding balance on capital related debt	(16,034,783)
Unspent capital related debt proceeds	2,288,379
	<u>\$ 33,472,946</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE I - FUND BALANCE

I. Fund balance classifications

The governmental fund balance classifications and amounts at June 30, 2015 are shown in the following table:

	<u>General</u>	<u>Community Development Block Grant Program</u>	<u>Bonds and Notes Issuance</u>	<u>Law No. 212</u>	<u>Debt Service</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Restricted:							
General public works and sanitation	\$ -	\$ -	\$ 243	\$ -	\$ -	\$ 97,662	\$ 97,905
Public safety	-	-	-	-	-	56,269	56,269
Sports, culture and recreation	-	-	-	-	-	157,140	157,140
Housing, welfare and community development	-	-	-	-	-	40,000	40,000
Education	-	-	-	-	-	350	350
Debt service	-	-	-	-	2,206,919	-	2,206,919
Capital outlays	-	-	2,371,390	-	-	1,057,852	3,429,242
General government and other purposes	-	-	3,240	-	-	20,361	23,601
	<u>-</u>	<u>-</u>	<u>2,374,873</u>	<u>-</u>	<u>2,206,919</u>	<u>1,799,634</u>	<u>6,381,426</u>
Assigned:							
General public works and sanitation	124,507	-	-	-	-	-	124,507
Public safety	1,115	-	-	-	-	-	1,115
Sports, culture and recreation	4,277	-	-	-	-	-	4,277
Housing, welfare and community development	5,038	-	-	-	-	-	5,038
Capital outlays	1,158,751	-	-	-	-	-	1,158,751
General government and other purposes	625,606	-	-	-	-	-	625,606
	<u>1,919,294</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,919,294</u>
Unassigned	2,209,265	(161,572)	-	(338,318)	-	(812,470)	896,905
	<u>\$ 4,128,559</u>	<u>\$ (161,572)</u>	<u>\$ 2,374,873</u>	<u>\$ (338,318)</u>	<u>\$ 2,206,919</u>	<u>\$ 987,164</u>	<u>\$ 9,197,625</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE I - FUND BALANCE – Continued

2. Fund balance deficits

Certain special funds included in the fund statements disclosed fund balance deficits. The most significant balances follow:

<u>Funds</u>	<u>Amount</u>
<u>Major Funds:</u>	
Community Development Block Grant Program	\$ 161,572
Law 212	\$ 338,318
<u>Other Governmental Funds:</u>	
P.R. Department of Labor – Law No. 52	\$ 214,531
Rural Development Corporation	\$ 205,282
Others	\$ 248,118

These deficits result from the recognition of deferred inflows of resources for unavailable revenues. As required by current standards, the Municipality recorded intergovernmental revenues for reimbursement (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available. Any amount not covered by the corresponding award will be covered with future budgetary appropriations of the general fund, if necessary.

NOTE J - PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property, the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2015 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

<u>Description</u>	<u>Personal Property</u>	<u>Real Property</u>
Basic property tax rate, which is appropriated for general purposes and accounted in the Municipality's general fund:	4.00%	6.00%
Percent that belongs to the Commonwealth's debt service fund:	1.03%	1.03%
Percent that belongs to the Municipality's debt service fund:	2.00%	2.00%
Total tax rate:	7.03%	9.03%
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department:	(.20%)	(.20%)
Total percent to be paid by taxpayers:	<u>6.83%</u>	<u>8.83%</u>

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE J - PROPERTY TAXES - Continued

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances, a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. A payable of \$33,785 resulting from the final settlement of fiscal year 2014-2015 is recorded as other long-term debt in the government-wide financial statements since it will not be paid with current available financial resources.

NOTE K - MUNICIPAL LICENSE TAXES

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15.

During the fiscal year ended June 30, 2015, the tax rates were as follows:

- a. Financial business – 1.50% of gross revenues
- b. Other organizations - .50% of gross revenues

Tax payment is due 15 days after each period due date or on July 15 and January 15 of the subsequent fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made along with tax return submission on or before five (5) business days after April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$531,306 is recorded as deferred inflows of resources.

NOTE L - SALES AND USE TAXES

As imposed by Commonwealth and Municipal laws and regulations, the citizens of Puerto Rico are subject to sales and use tax ("SUT") on a broad range of goods and services. The total tax is imposed at a combined 7% rate of which 6% belongs to the Commonwealth (collection process administered through the Puerto Rico Department of Treasury) and 1% for the municipalities (collection process administered through the Municipal Finance Corporation – "COFIM").

The tax is due the 20th day of each month based on tax collected in the preceding month. Merchants at the Municipality of Luquillo render their tax return and payment through COFIM's web site or through a bank institution.

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 Act No. 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. As a result of this legislation, the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

**COMMONWEALTH OF PUERTO RICO
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NOTE L - SALES AND USE TAXES - Continued

Act No. 18 known as the "Municipal Administration Fund Law" was effective February 1, 2014. This Act improves the financing capacity of the Puerto Rico Sales Tax Financing Corporation ("COFINA"), a component unit of the Commonwealth and a related entity of GDB and creates a special fund called "Municipal Administration Fund" ("FAM") under custody of GDB. The FAM permits the Municipalities to guarantee and pay long term debt and provide funds for its general operations. The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Municipality of Luquillo signed the agreement to be covered.

The FAM will be funded in all fiscal years with an amount attributable to the .5% of the Commonwealth's SUT for the current fiscal year once all required deposits by law have been made to COFINA from the 6% Commonwealth's SUT. The .5% is distributed as follows:

- a. .2% deposited in the Municipal Development Fund to be distributed to the municipalities to finance operational costs,
- b. .2% deposited in a Municipal Redemption Fund or may be deposited in the municipalities' general fund. The municipalities have the option to maintain funds in the Municipal Redemption Fund to increase its debt margin and,
- c. .1% deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

To the extent the amount of Commonwealth SUT collections available for deposit into the FAM during any fiscal year is less than the amount attributable to 0.5% of the Commonwealth sales and use tax for such fiscal year, the Commonwealth's General Fund is required to cover any such shortfall.

Act No. 19, effective on February 1, 2014, created the Municipal Finance Corporation ("COFIM"), a public corporation and a component unit of GDB. COFIM is authorized to issue bonds and use other financing mechanisms to pay or refinance all or a portion of the municipalities' debt obligations payable from the 1% municipal SUT. The Act includes provisions for municipalities that do not want to be covered by Act No. 18. Special rules apply for those municipalities. As discussed above the Municipality of Luquillo signed the agreement to be covered by Act No. 18.

The first collections of the 1% municipal SUT are deposited into the COFIM's sinking fund until the greater of: .3% of the 1% municipal SUT or an Annual Rental Fee ("RFA"). The RFA for fiscal year 2014-2015 is \$65,541,281 and thereafter will be 1.5% of the RFA of the preceding fiscal period. The excess amount of 1% municipal SUT remaining after the required deposit to the COFIM's sinking fund (the "1% Municipal Transfer") is transferred to the general fund of municipalities or to the Municipal Redemption Fund as decided by the municipality. If at any moment the required deposits to the COFIM's sinking fund were not sufficient to pay principal and interest of any outstanding obligation, the deficiency will be covered by appropriations of the Commonwealth's general fund budget.

The Act provides for monthly cash advances from GDB to the Municipalities within the first ten days of each month. These cash advances are necessary to address the cash shortfall caused by the timing delay resulting from the lag in availability of operational funds to the municipalities caused by interposing the COFIM (Act No. 19) and COFINA (Act No. 18) sinking fund requirements prior to making such funds available to the municipalities. Such

**COMMONWEALTH OF PUERTO RICO
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NOTE L - SALES AND USE TAXES- Continued

advances are payable from the amount to be received from 1% Municipal Transfer as a result of Act No. 19 and then from the FAM as a result of Act No. 18. If such cash advances exceeds the amount corresponding to the 1% Municipal Transfer and the FAM, the excess will be deducted on a prorata basis from the next fiscal year cash advances. Otherwise, the excess amount will be paid to the municipalities.

The COFIM Final Liquidation of the 1% Municipal Transfer disclosed that actual cash collections exceeded the cash advances by \$33,448. The amount was recorded as deferred inflows of resources in the governmental fund statements since is not available are required by current standards. The IVU Municipal Redemption Fund Final Liquidation also includes the FAM Municipal Development Fund since those funds are deposited in the IVU Municipal Redemption Fund to increase the Municipality's credit margin. The final liquidation disclosed that the actual cash collections exceeded the cash advances by \$28,354. The amount was recorded as deferred inflows of resources in the governmental fund statements since is not available are required by current standards.

For the year ended June 30, 2015, the Municipality recorded as revenue in the general fund \$638,156 which corresponds to the 1% Municipal Transfer and \$2,396 for interest and penalties. The debt service fund reported \$936,685 corresponding to the IVU Municipal Redemption Fund and the FAM Municipal Development Fund.

NOTE M - INTERGOVERNMENTAL REVENUES AND FEES, FINES AND CHARGES FOR SERVICES - GENERAL FUND

1. Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal subsidies and equalization fund sent by CRIM	\$ 4,157,612
Reimbursement from Commonwealth Government of Christmas Bonus expenditure	121,609
Commonwealth subsidies for payment of ERS's additional uniform contribution and special laws	122,606
	\$ 4,401,827

2. Fees, fines and charges for services revenues reported in the general fund are comprised of the following:

	Amount
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	\$ 1,439,679
Construction excise tax	138,135
Rental income	39,933
Licenses and permits	9,418
Fines	3,163
Other	6,230
	\$ 1,636,558

The amount reported as compensation in lieu of tax ("CELI") of \$1,439,679 is composed of \$1,008,057 of an estimated CELI plus \$431,622 representing the amortization of prior years' CELI amount used to finance the prior years' excess amount of annual energy charges over the CELI obligation as reported in Note F. The Municipality reported as CELI and as electric power expense the estimated amount of \$1,008,057 since PREPA has not reported to the Municipality the actual CELI and electric power expense to be reported in fiscal year 2014-2015 financial statements.

**COMMONWEALTH OF PUERTO RICO
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NOTE N - RETIREMENT PLAN

1. Plan description

The Municipality is a participating employer in a retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covered all regular full-time public employees working for the executive and legislative branches of the Commonwealth and the municipalities of Puerto Rico (including mayors); the firefighters and police of Puerto Rico and employees of certain public corporations not having their own retirement systems. Prior to July 1, 2013, the system operated under the following benefits structures:

- *Act No. 447 of May 15, 1951* ("Act 447") effective on January 1, 1952 for members hired up to March 31, 1990,
- *Act No. 1 of February 16, 1990* ("Act 1") for members hired on or after April 1, 1990 and ending on or before December 31, 1999,
- *Act No. 305 of September 24, 1999* (which amended Act 447 and Act 1) for members hired from January 1, 2000 up to June 3, 2013.

Employees under Act 447 and Act 1 are participants of a cost-sharing multiple employer defined benefit plan. Act 305 members are participants under a pension program known as System 2000, a hybrid defined contribution plan. Under System 2000, there was a pool of pension assets invested by the System, together with those of the current defined benefit plan. Benefits at retirement age were not guaranteed by the Commonwealth and were subjected to the total accumulated balance of the savings account. Effective on July 1, 2013, Act No. 3 of 2013 ("Act 3") amends the provisions of the different benefits structures under the ERS. Act 3 moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new defined contribution hybrid plan. Contributions are maintained by each participant in individual accounts. Credits to the individual accounts include (1) contributions by all members of ERS Act 447 and Act 1 defined benefit pension plans after June 30, 2013; (2) the retirement savings account as of June 30, 2013 of System 2000 participants and, (3) the investment yield for each semester of the fiscal year.

2. Benefits provided

Eligibility for retirement: Act 3 establish the following retirement eligibility requirements: (1) Act 447 regular employees upon attaining a range between 59 to 61 years (depending of date of birth) and 10 years of creditable service, (2) Act 1 employees upon attaining 55 years with 30 years of creditable service, (3) System 2000 regular employees upon attaining a range between 61 to 65 years (depending of date of birth) and, (4) Act 3 employees hired after July 1, 2013 upon reaching 67 years. High risk employees (state and municipal police, firefighters and custody officials) under Act 447 and Act 1 will be eligible at 55 years with 30 years of creditable service, for System 2000 employees at 55 years of service and for Act 1 employees hired after July 1, 2013 upon reaching 58 years.

Accrued benefits: All members are entitled to a lifetime annuity based on the balance of the deferred contribution individual account at the time of the retirement calculated based on a factor that will incorporate the individual's life expectancy and a rate of return. For Act 447 and Act 1 active participants, all retirement benefits accrued through June 30, 2013 were frozen, and thereafter, all future benefits accrue under Act 3 plan.

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NOTE N - RETIREMENT PLAN- Continued

These participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013 plus the lifetime annuity corresponding to contributions made to the individual account after July 1, 2013 as described above. Act 447 participants, except police and mayors, may elect to coordinate coverage with Social Security benefits ("Coordinated plan"). Under this option, participants are subject to a benefit recalculation upon attainment of the Social Security Retirement Age. For all members, if the balance of the defined contribution individual account is less than \$10,000 the amount shall be paid as a lump sum instead of an annuity. Effective July 1, 2013, the minimum monthly pension amount for members who retired or disabled before July 1, 2013 is \$500.

Termination benefit: Members are eligible to a lump sum payment of the defined contribution individual account as of the date of the permanent separation of service upon termination of service prior to 5 years of service or if the balance of the defined contribution individual account is less than \$10,000.

Deferred retirement: Members are eligible at the applicable retirement eligibility age to a lifetime annuity based on the balance of the deferred contribution individual account plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members) upon termination of service with 5 or more years of service (10 years of creditable service for Act 447 and Act 1 members) but prior to the applicable retirement eligibility, provided the member has not taken a lump sum withdrawal from the defined contribution individual account.

Death benefits: For non-retired members, their designated beneficiaries will receive a refund of the balance of the deferred contribution individual account plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members). For pensioned members retired prior to June 30, 2013, the annual income to a widow or widower or dependent children is equal to 60% of the retirement benefit payable for life for a surviving spouse or disabled children and payable until age 18 or age 25 if pursuing studies for non-disabled children. For pensioned members retired after June 30, 2013, payments to beneficiaries will be the excess, if any, of the balance of the deferred contribution individual account plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members) over the total annuity payments paid to the member and any beneficiaries.

Disability benefits: Members who are permanently separated from service due to total and permanent disability, due to disability pursuant to Act No. 127 of June 27, 1958, as amended, or due to terminal illness, as determined by the Administrator, shall be entitled to the balance of the deferred contribution individual account in a lump sum, or through the grant of an annuity, or any other optional form of payment pursuant to Section 5-110 of Act No. 447, at the option of the participant, plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members) at the applicable retirement eligibility age. Beginning on June 30, 2013, no disability pensions shall be awarded pursuant to Sections 2-107 thru 2-111 of Act No. 447. A disability benefits program is established which shall provide a temporary annuity in the event of total and permanent disability. Disability benefits may be provided through one or more disability insurance contracts with one or more insurance companies authorized by the Office of the Commissioner of Insurance of Puerto Rico to conduct business in Puerto Rico. The determination as to whether a person is partially or totally and permanently disabled shall be made by the insurance company that issues the insurance policy covering the participant.

Special laws and pensioner additional benefits: The Municipality is required to cover other retirement benefits of its retired employees (if retired prior to July 1, 2013) as required by Commonwealth's laws, including: (1) various special laws – ad-hoc cost of living allowance adjustments (COLA) provided in prior years; (2) various special laws –additional minimum pension benefits and, (3) Act 3 retired pensioners "Additional Benefits Program". All of these other retirement benefits are applicable only to employees who retired prior to July 1, 2013 under Act 447 and Act 1. The "Additional Benefits Program" includes: (1) a medication bonus of \$100

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NOTE N - RETIREMENT PLAN- Continued

per member which shall be paid no later than July 15 of each year; (2) a Christmas bonus of \$200 per member which shall be paid no later than December 20 of each year and, (3) a matching share of \$1,200 for healthcare insurance plan. These healthcare benefits are provided through insurance companies whose premiums are paid by the retired employees with the matching share financed by the Municipality.

3. Contributions

The Act No. 3 is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Contribution rates are not actuarially determined.

Members: All participants (non-coordinated plan) are required to contribute 10% of gross salary. Participants under the Coordinated Plan (only Act 447 participants with benefits coordinated with social security benefits, as described above) are required to contribute 8.5% of gross salary up to \$6,600 plus 10% of gross salary in excess of \$6,600 for fiscal year 2014-2015 and 10% of gross salary effective July 1, 2015. Members may voluntarily make additional contributions to their defined contribution individual account.

Payroll-based employer contribution: The Municipality contributed 13.275% of gross salary for fiscal year 2014-2015. Act 3 requires an additional 1% for the next fiscal year and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The Municipality contributed \$282,997 during fiscal year 2014-2015. These amounts represented the 100% of the required contribution for the corresponding year.

Additional Uniform Contribution: To improve the liquidity and solvency of the ERS, the Commonwealth enacted Act No. 32 of 2013, which amended Act 447 to provide for an Additional Uniform Contribution ("AUC"). The AUC will be financed by all participating employers (including the Municipality) of the ERS. Beginning with the 2014-2015 until the 2032-2033 fiscal year, the AUC will be the uniform contribution certified by the external actuary of the ERS at least 120 days prior to the start of each fiscal year, as necessary to avoid having the projected gross assets of the ERS, during any subsequent fiscal year, to fall below \$1,000,000,000. The ERS will determine the amount of AUC to be billed and paid by each employer during each fiscal year. Commonwealth laws provide for a subsidy of the AUC obligation, applicable to all participating employers (including the Municipality) of the ERS that the Puerto Rico Office of Management and Budget ("OMB") determines do not have financial capability to pay the AUC obligation. For fiscal year 2014-2015, the Municipality recorded \$78,625 as expenditure in the general fund and the OMB subsidy amounted to \$19,656.

Disability insurance: As described above, a disability benefits program is established which shall provide a temporary annuity in the event of total and permanent disability. All members shall mandatorily contribute to a disability insurance established by Act 3 for which participants shall have to contribute such sums, fixed in dollars or a percent of the salary determined by the ERS. The contribution required is equal to or less than .25% of the participant's salary. This contribution shall not be credited to the participant's deferred contribution individual account.

Special laws and pensioner additional benefits: These other retirement benefits are funded on a pay-as-you-go basis and billed by ERS to the Municipality at the beginning of each fiscal year. As required by Act 3, the invoice includes a supplemental contribution of \$2,000 per pensioner to finance the Additional Benefits

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NOTE N - RETIREMENT PLAN- Continued

Program. Commonwealth laws provide for a subsidy of this obligation, applicable to all participating employers (including the Municipality) of the ERS that the Puerto Rico Office of Management and Budget ("OMB") determines do not have financial capability to pay these other retirement benefits obligation. For the fiscal year 2014-2015, the Municipality recorded \$200,289 as expenditure in the general fund and the OMB subsidy amounted to \$102,950.

The Municipality recorded as other assets in the government-wide and fund statements \$25,773 of excess credits related to the AUC and special laws and additional pensioner benefits which will be applied to the fiscal year 2015-2016 expenditures.

4. Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions

On March 8, 2016, the ERS (through the Puerto Rico Department of Treasury) issued a *GASB Statement No. 68* report of unaudited information including pension amounts by employer and the corresponding employer allocation percentage. The Municipality disclosed the following based on the unaudited data reported by ERS and the ERS June 30, 2014 Actuarial Valuation Report:

At June 30, 2015, the Municipality reported a liability of \$22,739,173 for its proportionate share of the net pension liability (unaudited). The collective net pension liability, which amounts to \$30,092,029,000, (unaudited) was measured as of June 30, 2014. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of July 1, 2013 calculated based on a discount rate and actuarial assumptions and projected forward to June 30, 2014. There have been no significant changes between the valuation date of July 1, 2013 and the fiscal year end. The Municipality's proportion of the net pension liability was based on a projection of the Municipality's long-term share of contributions to the pension plan relative to the projected contributions of all ERS participants, actuarially determined. At June 30, 2014, the Municipality's proportion was .07557%.

For the year ended June 30, 2015, the Municipality recognized pension expense of \$1,304,058. Pension expense represents the change in the net pension liability during the measurement period, adjusted for actual contributions and the deferred recognition of changes in investment gain/loss, actuarial gain/loss, actuarial assumptions or method, and plan benefits. At June 30, 2015, the Municipality reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Unaudited amounts as reported by ERS	\$ 776,149	\$ 181,968
Municipality's contributions subsequent to measurement date	561,911	-
	\$ 1,338,060	\$ 181,968

The \$561,911 reported as deferred outflows of resources related to Municipality's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense in future fiscal years based on the average expected remaining service lives of all plan participants or in the case of projected and actual investment earnings in a five-year period. The detailed components of the deferred outflows of resources and deferred inflows of resources were not informed by ERS.

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NOTE N - RETIREMENT PLAN- Continued

5. Actuarial assumptions

The actuarial valuation was determined using the following actuarial methods and assumptions:

Valuation date	July 1, 2013, projected forward to June 30, 2014
Measurement date	June 30, 2014
Actuarial cost method	Entry age normal method
Actuarial assumptions:	
Compensation increases	3.0% per year, no compensation increases are assumed until July 1, 2017
Investment rate of return	6.75%, net of investment expenses
Discount rate	4.29%
Municipal bond rate	4.29%, based on Bond Buyer General Obligation 20-Bond Municipal Bond Index
Mortality	Pre-retirement mortality: RP-2000 Employee Mortality rates for males and females projected on a generational basis using Scale AA for general employees not covered by Act 127; RP-2000 Employee Mortality rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA for employees covered by Act 127. As generational tables, they reflect mortality improvements both before and after the measurement date. Post-retirement mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females. The rates are projected on a generational basis starting in 1994 using Scale AA. As generational table, it reflects mortality improvements both before and after the measurement date.
Mortality	Post-retirement disabled mortality: Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. No provision was made for the future mortality improvement for disabled retirees.

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for current valuation. The liability results as of June 30, 2014 are based on projecting the ERS obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability or losses. Most demographic assumptions used are based on a 2009 experience study using data as of June 30, 2003, June 30, 2005 and June 30, 2007. Certain demographic assumptions (termination and employment) were impacted by Act 3 reforms and were revised on the new retirement eligibility and expected future experience.

The investment rate of return of 6.75% reflects the asset allocation for the non-loan portion of the portfolio that was adopted by the ERS during December 2013 and the actuary's capital market assumptions as of June 30, 2014. It was slightly higher than the debt service of the senior pension funding bonds payable, which range from 5.85% to 6.55%.

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NOTE N - RETIREMENT PLAN- Continued

The pension plan's policy in regard to allocation of invested assets is established and may be amended by the ERS. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the System's financial condition for the benefits provided through the pension programs. The following was the ERS's adopted asset allocation policy as of June 30, 2014:

Asset Class	Target Allocation	Long-term Expected Rate of Return
Domestic Equity	25%	6.8%
International Equity	10%	7.6%
Fixed Income	64%	3.9%
Cash	1%	2.9%
	100%	

The long-term expected rate of return on pension benefits investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

6. Discount rate

The discount rate used to measure the total pension liability was 4.29% as of June 30, 2014. The asset basis for the date of depletion is the ERS's fiduciary net position. On this basis, the fiduciary net position is expected to be exhausted in the 2014-2015 fiscal year. The plan's fiduciary net position was not projected to be available to make all projected future payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability. The date of depletion of the actuarial report does not include any amounts from the Additional Uniform Contribution required by Act No. 32 of 2013 because of fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the Municipalities, in the event that their financial condition does not improve in the near term.

7. Sensitivity of the Municipality's proportionate share of the net pension asset to changes in the discount rate.

The following presents the Municipality's proportionate share of the net pension liability calculated using the discount rate of 4.29%, as well as what the Municipality's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1% point lower (3.29%) or 1% point higher (5.29%) than the current rate:

	1% decrease (3.29%)	Discount rate (4.29%)	1% increase (5.29%)
Municipality's share of net pension liability	\$ 25,801,330	\$ 22,739,173	\$ 20,203,399

8. Pension plan fiduciary net position.

Detailed information about the plan's fiduciary net position is available in the ERS audited financial statements as of and for the fiscal year ended June 30, 2014 issued on June 1, 2016.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE O - COMMITMENTS

1. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted to \$25,268. Management believes that the summary of the future minimum rental commitments under non-cancelable operating leases with terms exceeding one year is not significant.

2. Construction

As of June 30, 2015 the Municipality has commitments of \$377,609 for design, construction, improvements or renovation of certain municipal facilities.

3. Encumbrances

The Municipality has encumbrances outstanding which represent the estimated amount of expenditures required to complete contracts, purchase orders and other commitments in process of completion at fiscal year-end. Outstanding encumbrances as of June 30, 2015 in the general fund represent unassigned amounts that are encumbered and are classified by management as assigned fund balance. Purpose classification follows:

Purpose	General Fund- assigned fund balance
General government	\$ 207,958
Public Safety	1,115
Sports, culture and recreation	4,277
Welfare and community development	5,038
	\$ 218,388

Fund balance of major and other governmental funds (special revenue, capital project and debt service funds) is classified as restricted, some or all of which may be encumbered. Encumbrances of restricted fund balance are not reported separately from this classification because the encumbrance does not further restrict the purpose for which the resources may be used.

NOTE P - CONTINGENCIES

1. Federal and Commonwealth Grants

Projects financed by the Federal and Commonwealth Grants are subject to audits by grantors and other governmental agencies in order to determine that the expenditures comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that would not be covered by insurance. However, it is the opinion of the Municipality and the legal counsel that based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE Q - RESTATEMENT OF NET POSITION AND FUND BALANCE

The following tables disclosed the net change to net position \ fund balances at beginning of year as previously reported in the financial statements. The beginning balances have been restated as follows:

1. Governmental activities

Description	Amount	Net Position Government - wide Statements
Net position at beginning of year, as previously reported		\$ 39,424,704
Impact of implementation of <u>GASB Statements No. 68 and 71</u> :		
Net pension liability as of June 30, 2013 (GASB No. 68):	\$ (21,225,187)	
Deferred outflows of resources – employer contributions during 2013-2014 year (GASB No. 71):	<u>384,253</u>	(20,840,934)
Correction of errors – overstatement of sales and use tax receivable		(130,020)
Correction of errors –understatement of expenditures in general fund's special fund		(144,510)
Net position at beginning of year, as restated		<u>\$ 18,309,240</u>

2. Governmental funds

Funds	Fund balance at beginning of year, as previously reported	Changes in reporting entity	Correction of error- overstatement of sales and use tax receivable	Correction of error- understatement of expenditures in general fund's special fund	Fund balance at beginning of year, as previously reported-restated
General fund	\$ 3,515,152	\$ -	\$ (56,635)	\$ (144,510)	\$ 3,314,007
Special revenue fund, state and local grants	267,283	(267,283)	-	-	-
Special revenue fund, other federal grants	(303,031)	303,031	-	-	-
Capital projects fund, state and local grants	2,730,082	(2,730,082)	-	-	-
Debt service	3,051,250	-	(73,385)	-	2,977,865
Other governmental	29,669	960,881	-	-	990,550
USHUD - Community Development Block Grant Program	-	(334,153)	-	-	(334,153)
Bonds and notes issuance	-	2,405,924	-	-	2,405,924
Law No. 212	-	(338,318)	-	-	(338,318)
	<u>\$ 9,290,405</u>	<u>\$ -</u>	<u>\$ (130,020)</u>	<u>\$ (144,510)</u>	<u>\$ 9,015,875</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2015**

NOTE R - SUBSEQUENT EVENTS

Effective on July 1, 2015, the Commonwealth sales and use tax ("Commonwealth SUT") increased from a current 6% to a 10.5%, as required by Act No. 72 of May 29, 2015, an amendment to the Puerto Rico Internal Revenue Code of 2011, ("Act No. 72"). The Municipal SUT remains unchanged at 1% for a total SUT of 11.5%. The Act No. 72 also imposes a Commonwealth SUT of 4% to professional and business-to-business services rendered starting on October 1, 2015.

The Municipality has evaluated subsequent events through August 31, 2016 which is the date the financial statements were available to be issued. Except for the subsequent event mentioned above and the events disclosed in Note B, no additional events were identified that should be disclosed or adjusted in the basic financial statements or its related notes.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2015**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
<u>REVENUES:</u>				
Taxes:				
Property taxes	\$ 3,543,584	\$ 3,543,584	\$ 3,543,584	\$ -
Municipal license taxes	931,679	931,679	876,004	(55,675)
Sales and use taxes	604,049	604,049	640,552	36,503
Intergovernmental	2,883,343	2,883,343	2,896,952	13,609
Fees, fines and charges for services	1,203,229	1,203,229	1,204,936	1,707
Interest	80,000	80,000	180,494	100,494
Other	105,000	840,578	903,160	62,582
Total revenues	<u>9,350,884</u>	<u>10,086,462</u>	<u>10,245,682</u>	<u>159,220</u>
<u>EXPENDITURES:</u>				
Current:				
General government	5,291,267	6,145,083	6,123,467	21,616
Public works and sanitation	2,371,071	2,389,044	2,356,426	32,618
Public safety	146,876	222,370	209,388	12,982
Culture and recreation	305,594	290,483	283,103	7,380
Health	357,127	276,939	276,939	-
Welfare and community development	878,948	762,543	753,949	8,594
Total expenditures	<u>9,350,884</u>	<u>10,086,462</u>	<u>10,003,272</u>	<u>83,190</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 242,410</u>	<u>\$ 242,410</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
JUNE 30, 2015**

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1991, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared.

Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget, and the actual results under the budgetary basis of accounting.

The budgetary basis of accounting is different from accounting principles generally accepted in the United States of America (“US GAAP”). Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders or contracts) are considered expenditures when a commitment is made. On a US GAAP basis encumbrances outstanding at year-end are reported in the governmental fund balance sheet as assigned fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of the current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year-end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET TO GAAP RECONCILIATION

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
June 30, 2015**

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ 242,410
Budget to GAAP differences:	
Non-budgeted funds recorded as revenues for financial reporting purposes:	32,944
Non-budgeted funds recorded as expenditures for financial reporting:	(507,509)
Non-budgeted transfers in:	1,665,956
Non-budgeted transfers out:	(450,877)
Revenues recorded for financial reporting purposes but not in budgetary basis:	680,056
Revenues recorded in budgetary basis purposes but not in financial reporting:	(32,190)
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(799,753)
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	176,588
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(193,073)
Net change in fund balance (GAAP basis):	<u>\$ 814,552</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
FISCAL YEAR ENDED JUNE 30, 2015**

**SCHEDULE OF MUNICIPALITY'S PROPORTIONATE SHARE OF NET PENSION LIABILITY
LAST 10 YEARS (A)**

	<u>Fiscal year 2015 (B)</u>
Proportion of the net pension liability	0.07557%
Proportionate share of the net pension liability (c)	\$ 22,739,173
Covered-employee payroll (d)	\$ 3,147,523
Proportionate share of the net pension liability as a percentage of its covered-employee payroll (c)/(d)	722.45%
Plan's fiduciary net position as a percentage of the total pension liability	0.42%

**SCHEDULE OF MUNICIPALITY'S CONTRIBUTIONS
LAST 10 YEARS (A)**

	<u>Fiscal year 2015 (B)</u>
Statutorily required contribution	\$ 384,253
Contributions in relation to the statutorily required contribution (e)	384,253
Contribution deficiency (excess)	<u>\$ -</u>
Covered-employee payroll (f)	\$ 3,147,523
Contributions as a percentage of covered-payroll (e)/(f)	12.21%

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION –
SCHEDULE OF MUNICIPALITY'S PROPORTIONATE SHARE OF
NET PENSION LIABILITY
AND
SCHEDULE OF MUNICIPALITY'S CONTRIBUTIONS
JUNE 30, 2015**

NOTE A – LAST 10 YEARS

The Schedules are intended to show information for ten years. Additional years will be displayed as they become available. The information presented relates solely to the Municipality and not the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities as a whole.

NOTE B – FISCAL YEAR

The data provided in the schedule is based as of the measurement date of the net pension liability, which is as of the prior fiscal year ended June 30, 2014.

SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2015

Line Item No.	Description	14.871
	Balance Sheet	Housing Choice Vouchers
111	Cash - unrestricted	\$ 8,535
113	Cash - other restricted	\$ 5,597
100	Total cash	\$ 14,132
150	Total Current Assets	\$ 14,132
190	Total Assets	\$ 14,132
200	Deferred Outflow of Resources	\$ -
290	Total Assets and Deferred Outflow of Resources	\$ 14,132
333	Accounts payable - other government	\$ 4,325
310	Total Current Liabilities	\$ 4,325
353	Non-current liabilities - other	\$ 1,282
350	Total Non-current Liabilities	\$ 1,282
300	Total Liabilities	\$ 5,607
400	Deferred Inflow of Resources	\$ -
508.4	Net Investment in Capital Assets	\$ -
511.4	Restricted Net Position	\$ 4,421
512.4	Unrestricted Net Position	\$ 4,104
513	Total Equity/Net Position	\$ 8,525
600	Total Liabilities and Equity/Net Position	\$ 14,132
	Income Statement	
70600-010	Housing assistance payments	\$ 365,599
70600-020	Ongoing administrative fees earned	\$ 47,111
70600-070	Admin fee calculation description	
70600	HUD PHA operating grants	\$ 412,710
71400	Fraud recovery	\$ 300
71500	Other revenue	\$ 17,634
700	Total Revenue	\$ 430,644
91100	Administrative salaries	\$ 50,572
91900	Other	\$ 3,436
91000	Total Operating - Administrative	\$ 54,008
96900	Total Operating Expenses	\$ 54,008
97000	Excess Revenue Over Operating Expenses	\$ 376,636
97300-050	All Other	\$ 382,370
97300	Housing assistance payments	\$ 382,370
97350	HAP Portability-in	\$ 15,409
90000	Total Expenses	\$ 451,787
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$ (21,143)

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2015**

Line Item No.	Description	14.871
Line Item No.	Description	Housing Choice Vouchers
11030	Beginning equity	\$ 29,668
11170-001	Administrative Fee Equity - Beginning Balance	\$ 24,454
11170-010	Administrative Fee Revenue	\$ 47,111
11170-045	Fraud Recovery Revenue	\$ 150
11170-050	Other Revenue	\$ 17,634
11170-060	Total Admin Fee Revenues	\$ 64,895
11170-080	Total Operating Expenses	\$ 54,008
11170-095	Housing Assistance Portability In	\$ 15,409
11170-100	Other Expenses	\$ 11,407
11170-101	Comment For Other Expense	
11170-110	Total Expenses	\$ 80,824
11170-002	Net Administrative Fee	\$ (15,929)
11170-003	Administrative Fee Equity - Ending Balance	\$ 8,525
11170-005	Pre-2004 Administrative Fee Reserves	\$ -
11170-006	Post-2003 Administrative Fee Reserves	\$ 8,525
11170	Administrative Fee Equity	\$ 8,525
11180-001	Housing Assistance Payments Equity - Beginning Balance	\$ 5,214
11180-010	Housing Assistance Payments Revenues	\$ 365,599
11180-015	Fraud Recovery Revenue	\$ 150
11180-020	Other Revenue	\$ 11,407
11180-030	Total HAP Revenues	\$ 377,156
11180-080	Housing Assistance Payments	\$ 382,370
11180-100	Total Housing Assistance Payments Expenses	\$ 382,370
11180-002	Net Housing Assistance Payments	\$ (5,214)
11180-003	Housing Assistance Payments Equity - Ending Balance	\$ -
11180	Housing Assistance Payments Equity	\$ -
11190-210	Total ACC HCV Units	828
11190	Unit Months Available	828
11210	Unit Months Leased	772

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
JUNE 30, 2015**

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (“FDS”) is a trial balance of the financial statements of the Section 8 Housing Choice Voucher Program administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (“PHA”) to the Real Estate Assessment Center (“REAC”), as required by the Uniform Financial Reporting Standards (“UFRS”). REAC is the US Department of Housing and Urban Development’s (“HUD”) national management center created to assess the condition of HUD-owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD. Because the FDS presents only a selected portion of the operations of Municipality, it is not intended to, and does not present, the financial position and changes in net position of the Municipality.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements and is prepared using the accrual basis of accounting.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2015**

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures</u>
<u>U.S. Department of Housing and Urban Development</u>			
Direct programs:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	\$ 412,710
Passed-through programs from:			
<u>Office of Commissioner of Municipal Affairs:</u>			
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	14.228	AB - 41, FC - 41	<u>456,675</u>
Subtotal U.S. Department of Housing and Urban Development			869,385
<u>U.S. Department of Education</u>			
Passed-through program from:			
<u>P.R. Department of Education</u>			
Twenty-First Century Community Learning Centers	84.287	2014-AF-0151	1,346,510
<u>U.S. Department of Health and Human Services</u>			
Passed-through programs from:			
<u>P.R. Office of the Ombudsman for the Elderly:</u>			
Aging Cluster:			
Special Programs for the Aging_Tittle III Part B_ Grants for Supportive Services and Senior Centers	93.044	NAV	133,850
Nutrition Services Incentive Program	93.053	NAV	<u>18,400</u>
Total Aging Cluster:			152,250
<u>P.R. Department of Family - Families and Children Administration:</u>			
Child Care and Development Block Grant	93.575	NAV	<u>194,506</u>
Subtotal U.S. Department of Health and Human Services:			346,756
Total Expenditures of Federal Awards			<u>\$ 2,562,651</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2015**

NOTE A – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality under programs of the federal government for the year ended June 30, 2015. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements. Because the schedule presents only a selected portion of the operations of the Municipality, it is not intended to, and does not present, the financial position and changes in net position of the Municipality.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

NOTE C – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

Description	Community Development Block Grant Program	Other Governmental Funds
14.871	\$ -	\$ 412,710
14.228	456,675	-
84.287	-	1,346,510
93.044	-	133,850
93.053	-	18,400
93.575	-	194,506
Total federal awards expenditures:	456,675	2,105,976
Additional amount recorded as expenditures under modified accrual basis for Section 8 HCV Program:	-	35,482
Non-federal awards expenditures:	-	890,712
Total expenditures, fund statements:	<u>\$ 456,675</u>	<u>\$ 3,032,170</u>



López-Vega, CPA, PSC

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

**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 Luquillo
Luquillo, Puerto Rico**

We have audited, in accordance with the 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, the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the **Municipality of Luquillo**, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise **Municipality of Luquillo's** basic financial statements and have issued our report thereon dated August 31, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered **Municipality of Luquillo's** internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **Municipality of Luquillo's** internal control. Accordingly, we do not express an opinion on the effectiveness of **Municipality of Luquillo's** internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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 a timely basis. We considered the deficiencies described in the accompanying schedule of finding and questioned costs as item **2015-001** to be a material weakness.

A *significant deficiency* is a deficiency, or a 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 considered the deficiencies described in the accompanying schedule of findings and questioned costs as items **2015-001** to **2015-003** and **2015-005** to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether **Municipality of Luquillo's** financial statements are free from 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.

**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*
(CONTINUED)**

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

We noted certain matters that we reported to management of the **Municipality of Luquillo** in a separate letter dated August 31, 2016.



LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
August 31, 2016

Stamp No. 2728530 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors



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 ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY
OMB CIRCULAR A-133**

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

Report on Compliance for Each Major Federal Program

We have audited **Municipality of Luquillo'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 **Municipality of Luquillo's** major federal programs for the year ended June 30, 2015. **Municipality of Luquillo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

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

Opinion on Each Major Federal Program

In our opinion, **Municipality of Luquillo** complied, in all material respects, with the types of 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.

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY
OMB CIRCULAR A-133 (CONTINUED)**

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, 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 item 2015-006. Our opinion on each major federal program is not modified with respect to these matters.

Municipality of Luquillo's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. **The Municipality of Luquillo's** response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control over Compliance

Management of the **Municipality of Luquillo** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the **Municipality of Luquillo's** internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 **Municipality of Luquillo's** internal control over compliance.

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. 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 by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2015-002 to 2015-005 to be significant deficiencies.

Municipality of Luquillo's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. **Municipality of Luquillo's** response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY
OMB CIRCULAR A-133 (CONTINUED)**

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

We noted certain matters that we reported to management of the **Municipality of Luquillo** in a separate letter dated August 31, 2016.


LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
August 31, 2016

Stamp No. 2728531 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued: **Qualified for Government-wide FS,
Unmodified for Fund FS**

Internal control over financial reporting:

Material weakness identified? Yes No

Significant deficiencies identified not considered being material weaknesses? Yes No

Noncompliance material to financial statements noted? Yes No

Federal awards

Internal Control over major programs:

Material weakness identified? Yes No

Significant deficiencies identified not considered being material weaknesses? Yes No

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 No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grants/State’s Program and Non-Entitlement Grants in Hawaii
14.871	Section 8 Housing Choice Vouchers Program
84.287	Twenty-First Century Community Learning Centers
93.575	Child Care and Development Block Grant

Dollar threshold used to distinguish between Type A and Type B programs \$ 300,000

Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section II – Financial Statements Findings

This deficiency in internal controls is considered a material weakness (MW).

Finding Reference	2015-001
Requirement	Financial Reporting – Accounting Records (MW)
Statement of Condition	<p>During our examination of the Municipality’s accounting system, we noted that the Municipality’s accounting records for Local, State and Federal funds do not provide modified-accrual basis financial statements. Also, the accounting system does not offer subsidiaries to produce government-wide financial statements. The computerized systems utilized and the manual records maintained by Finance Department’s personnel do not provide financial information to generate the basic financial statements since the beginning balances were not properly presented in the accounting systems.</p> <p>As a result, the Municipality’s 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 the Law No. 81.</p> <p>In addition, prior period adjustments due to corrections of errors in the total amounts of \$(201,145) and \$(73,385) were made to the beginning fund balances of the General Fund and Debt Service Fund, respectively.</p>
Criteria	Chapter VIII, Article 8.010 of 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 updated and complete financial information that presents 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 the Municipality’s Management to implement internal controls and procedures in order to maintain a double entry accounting system that contains accurate information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.
Questioned Costs	None

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section II – Financial Statements Findings

Finding Reference **2015-001 - Continued**

**Management Response
and Corrective Action**

Beginning January 1, 2015, the Municipality implemented a new computerized accounting system that provides for double-entry accounting, general ledger and subsidiaries record keeping. We will review the beginning balances of all our funds' accounts to ensure that the correct data is entered in the system. Also, we will improve our monitoring internal controls so the accounting information is verified each month to ensure the least number of errors by years' end.

Implementation Date: 2016-2017 Fiscal Year

Responsible Person: Finance Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	2015-002
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	Allowable Activities - Housekeepers activity
Statement of Condition	We performed a housekeeper activity test of ten (10) participant files and we did not find the Program Approval Form (OCAM-AH-004A) in all ten (10) cases. In addition, in seven (7) cases, the Contract of Participation Form (OCAM-AH-005) was not approved by the participant or the Federal Programs Department Director, in addition, in one (1) case, the form was not on file.
Criteria	Code of Federal Regulations 24, Section 570.484 states that the Municipality must ensure that the Program’s funds benefit very low, low- and moderate income persons and retain documentation justifying its certification. Also, the Municipality has an operational guide that includes all procedures and program requirements for housekeeper activities.
Cause of Condition	The Municipality’s internal controls and procedures failed to ensure that the participant’s files include all the required documents to comply with Program requirements.
Effect of Condition	The Municipality is not in compliance with the Code of Federal Regulations 24, Section 570.484 and with the operational guide of the Program.
Recommendation	We recommend Management follows the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures manual, including the use of the standard forms included in it.
Questioned Costs	None
Management Response and Corrective Action	We concur with the finding. The Program will take steps to ensure that employees maintain program records containing all the information required for compliance with federal regulations and in order to ensure application of all of the procedures according to the Program’s operational guide.

Implementation Date: 2016-2017 Fiscal Year

Responsible Person: Federal Programs Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	2015-003
Program	Child Care and Development Block Grant (CFDA 93.575); U.S. Department of Health and Human Services; Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN)
Requirement	Cash Management (Days Elapsed)
Statement of Condition	The Municipality's internal control over compliance with the cash management requirements of federal program is not effective since it is not minimizing the time elapsed between the receipt and disbursement of funds. In our review, we noted that the Municipality made the disbursements between eleven (11) to fifty-six (56) days after the deposits.
Criteria	45 CFR Part 98.67 (a) Lead Agencies shall expend and account for CCDF funds in accordance with their own laws and procedures for expending and accounting for their own funds. (b) Unless otherwise specified in this part, contracts that entail the expenditure of CCDF funds shall comply with the laws and procedures generally applicable to expenditures by the contracting agency of its own funds.
Cause of Condition	The Municipality's disbursements procedures failed to ensure that funds requested and received from grantor be disbursed in compliance with the Code of Federal Regulations Requirements. The above conditions are the result of inadequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.
Effect of Condition	The Program is not in compliance with 45 CFR Part 98.67 (a) and (b).
Recommendation	The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by CCDF regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within five (5) days.
Questioned Costs	None
Management Response and Corrective Action	The Municipality will take adequate measures to streamline the process between the Finance Department and the Federal Department, to comply with the requirement to disburse the funds received in the established time.
	Implementation Date: During the fiscal year 2016-2017
	Responsible Person: Mrs. María Quiñonez Ortíz Child Care Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	2015-004
Program	Child Care and Development Block Grant (CFDA 93.575); U.S. Department of Health and Human Services; Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN)
Requirement	Reporting
Statement of Condition	During our audit procedures, we noted that the Program submitted the annual closing report for the program year seventy-two (72) days late as required by the recipient agency.
Criteria	45 CFR Part 98.67 (c) Fiscal control and accounting procedures shall be sufficient to permit: (1) Preparation of reports required by the Secretary under this subpart and under subpart H; and (2) The tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part.
Cause of Condition	The Program does not have effective internal controls to ensure that the required documentation and reports are submitted to the pass-through agency in the requested time frame.
Effect of Condition	The Program is not in compliance with 45 CFR Part 98.67- Fiscal Requirements (c) (1) (2).
Recommendation	Management should take the necessary steps to ensure that the Program submits its financial reports within the time frame required by the state pass-through agency.
Questioned Costs	None
Management Response and Corrective Action	<p>The Municipality will take adequate measures to establish effective internal controls to submit reports within the set dates.</p> <p>Implementation Date: During the 2016-2017 fiscal year</p> <p>Responsible Person: Mrs. María Quiñonez Ortíz Child Care Program Director</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	2015-005
Program	Twenty-First Century Community Learning Centers (CFDA No. 84.287); U.S. Department of Education; Pass-through Commonwealth of Puerto Rico–Department of Education
Requirement	Reporting
Statement of Condition	In our Reporting Test, we review the Achievement Report to test compliance of 80% assistance of each student to the classes and student proficiency in the Puerto Rican tests also known in spanish as “Pruebas Puertorriqueñas”. Our test shows that the Program did not maintain a complete set of records available to perform our audit procedures to verify accuracy of the information submitted.
Criteria	Proposal Objective Item 1.2 states that the Program must comply with 80% students’ participation to the academic skills development.
Cause of Condition	Adequate internal controls and proper monitoring procedures do not exist to ensure accuracy within the information reported in the Achievement Report and supporting documents as required by the Program’s regulations and grant agreement.
Effect of Condition	The Program is not in compliance with the Proposal Objective Item 1.2.
Recommendation	We recommend the Program establishes internal control procedures to ensure the accuracy and completeness of database and correct preparation and submission of the Achievement Report.
Questioned Costs	None
Management Response and Corrective Action	Administrative changes will be made to assure that all the report records contain all the necessary evidence needed to corroborate the information submitted to the Puerto Rico Department of Education. The Puerto Rican Tests are administered by the Department and the results of the tests were not available until late 2015; for that reason, the measurement of the proficiency in the tests was not included with the Achievement Report.
	Implementation Date: During the fiscal year 2016-2017
	Responsible Person: Mrs. Elia González López 21 st Century Community Learning Center Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	2015-006
Requirement	Single Audit Act (NC)
Statement of Condition	The Single Audit Report for the fiscal year ended June 30, 2015 was not issued within nine (9) months after the end of the audit period.
Criteria	The Single Audit Act of 1984, as amended, requires that the audit report must be submitted to the Federal Audit Clearinghouse no later than nine (9) months after the end of the audit period.
Cause of Condition	The Municipality's audited financial information was not available as of March 31, 2016.
Effect of Condition	The Municipality could lose federal grants due to the noncompliance with the Single Audit Act requirements.
Recommendation	Procedures should be implemented to ensure that the Municipality complies with the established Federal Regulation, as prescribed by OMB Circular A-133.
Questioned Costs	None
Management Response And Corrective Action	The Municipality's management will improve internal controls procedures related to record keeping and year-adjustments in order to ensure compliance with the March 31 federal requirement. Responsible Person: Finance Department Director Implementation Date: March 31, 2017

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO
SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS AND QUESTIONED COSTS
JUNE 30, 2015**

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
2014-002	14.228	<p><u>We performed a housekeeper activity test of ten (10) participant files and we did not find the Program Approval Form (OCAM-AH-004A) in all ten (10) cases. In addition, in one (1) case, we did not find the Contract of Participation Form (OCAM-AH-005).</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 2015-002.</p>
2014-003	14.871	<p><u>We noted that the Section 8 Housing Choice Vouchers Program did not maintain a HAP register in the form required by HUD. The PHA is required to maintain a HAP contract register or similar record that must provide information as to the name and address of the family, the name and address of the owner, dwelling unit size, the beginning date of the lease term, the monthly rent payable to the owner, monthly rent payable by the family to the owner, and the monthly HAP. The record shall also provide data as to the date the family vacates and the number of days the unit is vacant if any.</u></p> <p>Full corrective action was taken.</p>