

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

MUNICIPIO DE AIBONITO
AUDITORÍA 2010-2011
30 DE JUNIO DE 2011

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO**

SINGLE AUDIT REPORT

Fiscal Year Ended

June 30, 2011

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULE**

With Independent Auditors' Report Thereon

June 30, 2011

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Commonwealth of Puerto Rico
Municipality of Aibonito
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Independent Auditors' Report on Basic Financial Statements and Supplementary Schedule of Expenditures of Federal Awards

The Honorable Mayor, Members
of the Municipal Legislature and
People of the Municipality of Aibonito,
Commonwealth of Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico (the Municipality), as of and for the fiscal year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As discussed in Note 1, the Municipality did not have complete and accurate accounting records of its capital assets acquired or constructed before January 9, 2009. In addition, the Municipality did not perform a physical inventory of such capital assets during the last five fiscal years, which ultimately affects the valuation of such assets at June 30, 2011. Accordingly, we could not apply adequate auditing procedures to ascertain the existence, valuation and ownership of those capital assets recorded in the accompanying statement of net assets for \$19,528,897, net of accumulated depreciation of \$13,040,981.

As discussed in Note 7, the other (nonmajor) governmental funds of the Municipality reported as part of its assets, the balances due from other governmental funds amounting to \$1,901,445 at June 30, 2011 of which \$1,900,733 represent unsupported inter-fund loans carried over from January 9, 2009 without being collected. The Municipality did not have complete and accurate accounting records of inter-fund balances recorded in books on or before January 9, 2009, including a subsidiary record documenting the collection procedures made by management and the repayment and other terms and conditions of inter-fund loans, transfers and reimbursements among governmental funds. These conditions raise substantial doubts about the existence and valuation of a portion of the other (nonmajor) governmental funds' uncollected inter-fund advances amounting to \$1,900,733 at June 30, 2011. The ultimate outcome of the existence, valuation and collectibility of the aforementioned inter-fund advances cannot presently be determined.

In our opinion, except for the matters discussed in the preceding paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major governmental fund and the aggregate remaining governmental fund information of the Municipality of Aibonito, Commonwealth of Puerto Rico, as of June 30, 2011, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position, the changes in financial position and cash flows of the business-type activities of the Municipality of Aibonito, Commonwealth of Puerto Rico, as of June 30, 2011, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards we have also issued our report dated November 28, 2011, on our consideration of the Municipality of Aibonito of the Commonwealth of Puerto Rico internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting and or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Budgetary Comparison Information on pages 4 through 19 and 74 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States and Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the Municipality. The Schedule of Expenditures and Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with

auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

November 28, 2011
Toa Alta, Puerto Rico

Stamp No. 2596733
was affixed to the
original report.



CPA - PSC

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2011

As management of the Municipality of Aibonito (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2011. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the accompanying financial statements, which follow this narrative.

As more fully described in Note 1, On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). Based on the criteria established by GASB No. 39, the Municipality's management concluded that there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2011. Therefore, Las Flores Apartments (FmHA and HUD Project No. 63-005-660-43-3572) was reported as a business-type activity and not as a component unit of the Municipality as of and for the fiscal year ended June 30, 2011.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's total assets amounted to \$59,148,192 at June 30, 2011, of which \$37,462,470 (63%) consist of capital assets (net of accumulated depreciation and amortization of \$16,280,741), \$18,602,270 (32%) consist of cash and cash equivalents, (of which \$14,955,579 are restricted for specific purposes), \$2,625,836 (4%) consist of accounts receivable, net of the reserve for doubtful account, and \$457,616 (1%) consist of other assets.
- The Municipality's total liabilities amounted to \$21,189,481 at June 30, 2011, of which \$15,546,431 consist of bonds and notes payable, \$2,079,328 consist of unearned revenues, \$2,370,816 consist of accounts payable and accrued liabilities, and \$1,192,906 consist of accrued compensated absences.
- The Municipality's assets exceeded its liabilities (net assets/surplus) by \$37,958,711 at June 30, 2011.
- The Municipality's total revenues amounted to \$15,829,977 for the fiscal year ended June 30, 2011, of which \$5,476,518 arose from taxes, \$8,918,044 arose from intergovernmental grants and contributions, and \$1,435,415 arose from charges for services, interest on deposits and miscellaneous revenues.
- The Municipality's expenses amounted to \$12,612,445 for the fiscal year ended June 30, 2011, of which \$8,350,549 were incurred in providing direct services and benefits to citizens in relation to urban and economic development, health and sanitation, public safety, public housing and welfare, and culture, recreation and education. In addition, the Municipality incurred \$492,074 of its total expenses, in interests related to its long-term obligations, and \$3,769,822 (in general government activities to support the Municipality's functions and programs. The Municipality's expenses include depreciation in the amount of \$1,610,225, for the fiscal year ended June 30, 2011.

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- The Municipality's net assets increased by \$3,217,532 during the fiscal year ended June 30, 2011.

Governmental Funds' Highlights:

- The total fund balance of governmental funds amounted to \$16,370,038 at June 30, 2011, of which \$661,118 are assigned, \$15,621,954 are restricted, and \$86,966 represents an unassigned balance.
- The total fund balances of governmental funds increased by \$6,781,289 during the fiscal year ended June 30, 2011.

Proprietary Fund Highlights:

- The total restricted fund net assets of the proprietary fund amounted to \$1,532,078, of which \$1,058,588 are invested in capital assets, net of related debt, while \$473,490 are restricted for the operations of federally funded programs.
- The total restricted fund net assets of the proprietary fund increased by \$1,285 during the fiscal year ended June 30, 2011.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2011. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include three components: (1) government-wide financial statements (GWFS), (2) fund financial statements (FFS), and (3) notes to the basic financial statements (NBFS). This report also contains additional required information in addition to the basic financial statements themselves. These components are described below.

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental and proprietary funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

MUNICIPALITY OF AIBONITO
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a) *Government-wide Financial Statements*

The GWFS are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2011. The GWFS are prepared using methods that are similar to those used by most private businesses.

Both of the government-wide financial statements distinguish functions of the Municipality that are principally supported by taxes and intergovernmental activities (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*).

1. Statement of Net Assets

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality. On the other hand, the Municipality reports liabilities, such as claims and judgments, bonds and notes payable, obligations under capital leases, compensated absences and certain accounts payable and accrued liabilities, even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets and total liabilities reported in SNA is presented as *net assets*, which is similar to the total owners' equity reported by a commercial enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net assets, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

2. Statement of Activities

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2011, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although SA looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial

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enterprise represents its net income, the Municipality reports an amount described as *net change in net assets*, which is essentially the same concept.

The focus of SA is on the *net cost* of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions. The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid, and other sources of resources.

This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and GFFS present all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions). All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; public housing and welfare; and economic and urban development.

b) Fund Financial Statements

The Municipality's FFS consist of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds, (3) the statement of net assets – proprietary fund, (4) the statement of revenues, expenses and changes in fund net assets –proprietary fund, and (5) the statement of cash flows – proprietary fund. These financial statements report the financial position, the results of operations and cash flows of the Municipality's governmental and proprietary funds, with an emphasis on the Municipality's major governmental and proprietary funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions. All of the funds of the Municipality can be divided into two categories: governmental funds and proprietary funds.

1. Governmental funds

Governmental funds are used to account for most of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS. Unlike GWFS, the focus of governmental funds in the FFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, governmental funds in FFS report the Municipality's operations in more detail than the GWFS.

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Governmental funds in FFS provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, (4) capital projects funds and (5) permanent funds.

Governmental funds FFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, governmental funds FFS focus on near-term inflows and outflows of expendable financial resources, consequently, they measure and account for cash and other assets that can easily be converted to cash. For example, amounts reported on the balance sheet include capital assets within a very short period of time, but do not include capital assets such as land and buildings. Governmental fund liabilities generally include amounts that normally are going to be paid within a short period after the end of the fiscal year. The difference between a fund's total assets and total liabilities is reported as the fund balance or deficit, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

Because the focus of governmental funds FFS is narrower than that of the GWFS, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the GWFS. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions. Both the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and the governmental activities reported in the government-wide financial statements.

The Municipality has five major governmental funds. Each major fund is presented in a separate column in the balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds. The five major governmental funds are: (1) general fund, (2) debt service fund, (3) capital projects fund, (4) legislative joint resolutions fund, and (5) special communities trust fund.

2. Proprietary fund

The proprietary fund is a fund used to report the financial position, results of operation and cash flows of Las Flores Apartments (FmHA and Hud Project No. 63-005-660-43-3572). Is a housing development consisting of eighty-four (100) dwelling units located in Aibonito. The project is owned by the Municipality, but its operations are carried out by a private management agent unrelated to the Municipality. The housing development project of Las Flores Apartments has been designed to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operates under financing through the Section 8 New Construction and Substantial Rehabilitation Program of the U.S. Department of Housing and Urban Development and

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the Section 515 Rural Rental Housing Loans Program of the U.S. Department of Agriculture. The purpose of Las Flores Apartments is to provide adequate housing to low-income residents of the Municipality.

The activities of Las Flores Apartments have been reported as a proprietary fund in the accompanying basic financial statements since GAAP permits the use of enterprise funds to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees or user charges.

Proprietary funds provide the same type of information as the GWFS, but in more detail.

c) Notes to Basic Financial Statements

The NBFS provide additional information that is essential for a full understanding of the data provided in the GWFS and GFFS. The NBFS can be found immediately following the basic financial statements.

d) Other Supplementary Information

The basic financial statements are followed by a section of other supplementary information consisting of: (1) budgetary comparison schedule – general fund and the Schedule of Expenditures of Federal Awards.

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FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall financial position and operations for the prior and the current fiscal year are summarized as follows, based on the information included in the accompanying GWFS:

Condensed Statement of Net Assets
Governmental Activities
June 30, 2011 and 2010

	2011	2010
Assets:		
Current assets	\$ 21,254,045	\$ 17,148,903
Noncurrent assets:		
Capital assets, net of accumulated depreciation	37,462,470	36,832,666
Other assets	431,677	420,841
Total assets	59,148,192	54,402,410
Liabilities:		
Current liabilities	4,430,859	4,005,232
Long-term obligations due within one year	1,018,834	722,701
Long-term obligations due after one year	15,739,788	11,597,219
Total liabilities	21,189,481	16,325,152
Net assets (deficit):		
Invested in capital assets, net of debt	31,279,639	33,013,200
Restricted	7,208,248	5,886,265
Unrestricted, as restated	(529,176)	(822,207)
Total net assets	\$ 37,958,711	\$ 38,077,258

At June 30, 2011, the Municipality's current assets, amounting to \$21,254,045, are mainly composed of cash and cash equivalents (\$18,602,270), accounts receivable (\$2,625,836), net of reserve for doubtful accounts and other assets (\$25,939).

The restricted cash represents resources legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant programs. Restricted cash also consists of unspent proceeds of bonds issued for acquisition, construction and improvement of major capital assets. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's non-current assets, amounting to \$37,894,147 at June 30, 2011, are composed of capital assets, with a cost basis of \$53,743,211, which are reported net of accumulated

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Management's Discussion and Analysis
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depreciation and amortization of \$16,280,741 and other noncurrent assets, amounting to \$431,677.

At June 30, 2011, the Municipality's current liabilities amounting to \$5,449,693 are mainly composed of accounts payable and accrued liabilities (\$2,351,531), unearned revenues (\$2,079,328), and the portions due within one year (\$1,018,834) of bonds and notes payable and compensated absences. Unearned revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded grant programs.

The Municipality's non-current liabilities, amounting to \$15,739,788 at June 30, 2011, are mainly composed of portions due after one year of bonds and notes payable (\$15,060,665) compensated absences (\$659,838) and other liabilities (\$19,285)

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. The assets of the Municipality exceeded liabilities by \$37,958,711 at June 30, 2011. The most significant portion of net assets (\$31,279,639) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, furniture, fixtures, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since capital assets cannot be used to liquidate these liabilities.

Another significant portion of net assets (\$7,208,248) at June 30, 2011, represents resources that are restricted for debt service payments, capital projects and other purposes.

The remaining component of total net assets consists of unrestricted net liabilities amounting to \$529,176 at June 30, 2011. These unrestricted net liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds and notes payable, compensated absences, claims and judgments, certain obligations under capital leases, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality increased by \$3,217,532 during the fiscal year ended June 30, 2011.

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MUNICIPALITY OF AIBONITO
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Management's Discussion and Analysis
Fiscal Year Ended June 30, 2011

The following is a condensed presentation of the Municipality's results of operations as reported in the GWFS:

Condensed Statement of Activities
Governmental and Business-Type Activities
Fiscal Years Ended June 30, 2011 and 2010

	2011	2010
Program revenues:		
Program-specific operating grants and contributions	\$ 3,574,734	\$ 1,580,960
Program-specific capital grants and contributions	1,530,840	1,044,039
Charges for services	76,852	89,474
Total program revenues	5,182,426	2,714,473
General revenues:		
Property taxes	2,733,968	3,311,151
Municipal license taxes	1,793,839	1,437,156
Construction excise taxes	332,059	386,777
Sales and use tax	616,652	610,077
Unrestricted grants and contributions	3,812,470	4,318,621
Interest on deposits	337,699	679,803
Other general revenues (various sources)	1,020,864	204,927
Total general revenues	10,647,551	10,948,512
Total revenues	15,829,977	13,662,985
Program expenses:		
General government	3,769,822	3,062,598
Urban and economic development	5,411,768	4,703,436
Health and sanitation	359,544	11,792
Public safety	102,538	116,901
Public housing and welfare	1,292,067	1,616,774
Culture, recreation and education	1,184,632	789,576
Interest on long-term obligations	492,074	317,899
Total expenses	12,612,445	10,618,976
Net increase in net assets	3,217,532	3,044,009
Net assets, at beginning of fiscal year	38,077,258	35,033,249
Prior-period adjustments	(3,336,079)	-
Net assets, at beginning of fiscal year, as restated	34,741,179	35,033,249
Net assets, at end of fiscal year	\$ 37,958,711	\$ 38,077,258

As previously mentioned, the Municipality's net assets increased by \$3,217,532 during the current fiscal year. Approximately 35% of the Municipality's total revenues for the current fiscal year came from property, municipal license, construction excise taxes and sales and use taxes (\$5,476,518). Grants, contributions and charges for services (program revenues), amounting to \$8,994,896, provided 57% of the total revenues for the current fiscal year. Miscellaneous revenues and interest on deposits provided the remaining 8% of total revenues.

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The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2011 were related to: (1) urban and economic development (\$5,411,768), (2) general administrating and operating costs (\$3,769,822) which were classified as "general government", (3) public housing and welfare (\$1,292,067), (4) culture, recreation and education (\$1,184,632), (5) interest on long-term obligations (\$492,074), (6) health and sanitation (\$359,544), and (7) and public safety (\$102,538). These expenses include depreciation and amortization of capital assets in the amounts of \$1,610,225 for the fiscal year ended June 30, 2011.

FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

Analysis of Financial Position of Governmental Funds

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's compliance with finance-related legal requirements. Specifically, unreserved fund balance may serve as a useful measure of the Municipality's net resources available for spending at the end of the fiscal year.

At June 30, 2011, the total assets of governmental funds amounted to \$24,500,632, which consisted principally of: (1) cash and cash equivalents of \$18,525,086 (2) accounts receivable, \$2,621,844, net of reserve for doubtful accounts, and (3) inter-fund receivables of \$3,353,702. Such assets are restricted for debt service, capital projects, encumbrances and other specific purposes.

At June 30, 2011, the total liabilities of governmental funds amounted to \$8,130,594, which consisted principally of: (1) accounts payable and accrued liabilities of \$2,327,564, (2) deferred revenues of \$2,079,328, (3) inter-fund payables (\$3,353,702) and (4) matured bonds due and payable of \$370,000.

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The fund balances of governmental funds increased by \$6,781,289 during the fiscal year ended June 30, 2011.

Condensed Balance Sheet - Governmental Funds
June 30, 2011 and 2010

	2011	2010
Assets:		
Total assets - major governmental funds	\$ 21,383,951	\$ 17,272,311
Total assets - other governmental funds	3,116,681	2,833,226
Combined total assets	\$ 24,500,632	\$ 20,105,537
Liabilities:		
Total liabilities - major governmental funds	\$ 6,938,965	\$ 6,273,126
Total liabilities - other governmental funds	1,191,629	907,583
Combined total liabilities	8,130,594	7,180,709
Fund balances:		
Assigned or restricted - major governmental funds	14,358,020	11,240,907
Assigned or restricted - other governmental funds	1,925,052	1,925,643
Unassigned - all governmental funds	86,966	(241,722)
Combined total fund balances	16,370,038	12,924,828
Total liabilities and fund balances	\$ 24,500,632	\$ 20,105,537

Major Governmental Funds

General fund (GF) – The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$6,419,541 at June 30, 2011. Such assets consist principally of: (1) cash and cash equivalents (\$3,646,691), (2) property tax, municipal license tax, construction excise tax, sales and use tax, and intergovernmental grants and contributions receivable (\$2,147,898), and (3) short-term and long-term amounts due from other funds (\$624,952).

The GF's total liabilities amounted to \$5,671,457 at June 30, 2011. Such liabilities are composed mainly of: (1) intergovernmental payables (\$1,188,345), (2) deferred revenues (\$1,078,710), (3) accounts payable and accrued liabilities (676,364), and short-term and long term amounts due to other funds (\$2,728,038).

At the end of the current fiscal year, unassigned fund balance of the GF amounted to \$86,966, while total fund balance amounted to \$748,084.

Capital projects fund (CPF) - The CPF's total assets amounted to \$9,410,557 at June 30, 2011, which consist mainly of cash and cash equivalents (\$9,147,880), intergovernmental grants and contributions receivable (\$230,602) and accrued interest on deposits (\$32,075). The CPF's total liabilities amounted to \$585,094 at June 30, 2011, which are mainly composed of accounts payable and accrued liabilities (\$171,115) and short-term and long-term amounts due to other

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funds (\$413,979). At the end of the current fiscal year, CPSF's total restricted fund balance reached \$8,825,463.

Debt service fund (DSF)- The DSF's total assets amounted to \$2,460,957 at June 30, 2011, which consist mainly of restricted cash in fiscal agent (\$2,404,744), restricted property taxes receivable, net of reserve for doubtful accounts (\$6,193), intergovernmental grants and contributions receivable and others (\$49,869). The DSF's total liabilities amounted to \$661,777 at June 30, 2011, which are mainly composed of: (1) matured bonds and interests due and payable (\$370,000), (2) accounts payable and accrued liabilities (\$291,740), (3) and due to other funds (\$37).

Legislative joint resolutions fund (LJRF) - The LJRF's total restricted assets amounted to \$3,092,896 at June 30, 2011, which consist of cash in a commercial bank (\$2,263,745), due from other funds (\$826,803) and accrued interest on deposits (\$2,348). At the end of the current fiscal year, LJRF's total fund balance is \$3,072,259.

Other governmental funds (OGF)- The OGF's total assets amounted to \$3,116,681 at June 30, 2011, which consist mainly of restricted cash and cash equivalents (\$1,062,026), due from other funds (\$1,901,947), intergovernmental grants and contributions (\$152,636), and accrued interest receivable (\$72). The OGF's total liabilities amounted to \$1,191,629 at June 30, 2011, which are mainly composed of deferred revenues (\$1,000,618) and short-term and long-term amounts due to other funds (\$191,011).

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MUNICIPALITY OF AIBONITO
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Analysis of Operating Results of Governmental Funds

**Condensed Statement of Revenues, Expenditures and Changes
in Fund Balances - Governmental Funds
Fiscal Years Ended June 30, 2011 and 2010**

	2011	2010
<i>Revenues:</i>		
Total revenues - major governmental funds	\$ 14,739,238	\$ 12,744,192
Total revenues - other governmental funds	539,092	386,237
Combined total revenues	15,278,330	13,130,429
<i>Expenditures:</i>		
Total expenditures - major governmental funds	12,741,653	9,356,803
Total expenditures - other governmental funds	605,388	357,333
Combined total expenditures	13,347,041	9,714,136
<i>Deficiency of revenues under expenditures</i>	1,931,289	3,416,293
<i>Other financing sources, net:</i>		
Other financing sources, net - major governmental funds	4,851,379	28,904
Other financing uses, net - other governmental funds	(1,379)	(28,904)
Combined other financing sources (uses), net	4,850,000	-
<i>Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses</i>	6,781,289	3,416,293
<i>Fund balance, at beginning of fiscal year</i>	12,924,828	9,508,535
<i>Prior-period adjustments</i>	(3,336,079)	-
<i>Fund balance, at beginning of fiscal year (restated)</i>	9,588,749	9,508,535
<i>Fund balance, at end of fiscal year</i>	\$ 16,370,038	\$ 12,924,828

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Major Governmental Funds

General fund – The total fund balance of the GF increased by \$302,610 during current fiscal year.

Approximately 50% (\$4,987,357) of the GF's total revenues for the current fiscal year came from property, municipal license, construction excise taxes and sales and use taxes, while 38% (\$3,812,470) resulted from intergovernmental grants and contributions.

The largest expenses of the GF for the fiscal year ended June 30, 2011 were related to: (1) general administrating and operating costs (\$3,523,199), (2) construction, rehabilitation and preservation of new or existing housing, (\$4,008,354), which were classified as "urban and economic development, (3) culture, recreation and education (\$1,181,064), (4) health and sanitation (\$359,359), and (5) capital outlay (\$491,571).

Capital projects funds (CPF) - The total fund balance of the CPF increased by \$4,452,536 during current fiscal year. CPF's total revenues for the current fiscal year came from intergovernmental grants and contributions amounting to \$735,672 and accrued interest on deposits amounting to \$172,326. CPF's total expenditures for the current fiscal year were mainly related to capital outlays, (\$923,537) and public housing and welfare (\$145,313).

Debt service fund (DSF) – The total fund balance of the DSF increased by \$240,284 during current fiscal year. Approximately \$489,161 of DSF's total revenues for the current fiscal year came from restricted property taxes. DSF's total expenditures for the current fiscal year came from principal and interests on bonds payable (\$893,079).

Legislative joint resolutions fund (LJRF) - The total fund balance of the LJRF increased by \$1,853,534 during current fiscal year. LJRF's total revenues for the current fiscal year came principally from state legislative assignments and contributions amounting to \$2,647,755 and interest on deposits amounting \$21,584. LJRF's total expenditures for the current fiscal year came from capital outlay (\$815,805).

Other governmental funds (OGF) – Substantially all of OGF's revenues for the current fiscal year came from intergovernmental grants and contributions of \$533,920 and interest on deposits of \$5,172. Total expenditures were mainly related to public housing and welfare (\$412,479) and general administration (\$192,909).

FINANCIAL ANALYSIS OF BUSINESS-TYPE ACTIVITIES

Analysis of Financial Position of Proprietary Fund

At June 30, 2011, the total assets of proprietary fund amounted to \$2,440,538, which consisted principally of: (1) restricted cash in commercial banks (\$77,184), (2) capital assets net of accumulated depreciation (\$1,923,796), and other assets (\$435,566).

At June 30, 2011, the total liabilities of the proprietary fund amounted to \$908,460, which consisted principally of: (1) mortgage notes payable of \$865,208, and (2) accounts payable and accrued liabilities of \$43,252.

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The total restricted net assets of proprietary fund amounted to \$1,532,078 at June 30, 2011, of which \$1,058,588 are invested in capital assets, and \$473,490 are reserved for program activities. The following table presents a summary of the financial position of the proprietary fund (PF) at June 30, 2011:

<i>Assets:</i>	
Total current assets	\$ 85,065
Total non-current assets	2,355,473
Total assets	2,440,538
 <i>Liabilities:</i>	
Total current liabilities	105,645
Total non-current liabilities	802,815
Total liabilities	908,460
 <i>Net assets:</i>	
Invested in capital assets, net of related debt	1,058,588
Restricted for federal funded program	411,757
<i>Total restricted net assets</i>	1,470,345
<i>Unrestricted net assets</i>	61,733
<i>Total net assets</i>	\$ 1,532,078

CAPITAL ASSETS AND DEBT ADMINISTRATION

a) Capital Assets

The Municipality has invested \$48,579,655 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$13,040,981 at June 30, 2011. The net capital assets increased during the current fiscal year due to the current fiscal year's capital additions (\$789,866), which were partially offset by the depreciation and amortization expense.

b) Debt Administration

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

At June 30, 2011, the Municipality's total bonded debt amounted to \$14,556,616 consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. The Municipality has also certain outstanding notes payable. Such notes payable also decreased

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during the current fiscal year mainly due to the principal payments made during the same period.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Aibonito, Department of Finance.

MUNICIPALITY OF AIBONITO

**Basic Financial Statements,
Notes to Basic Financial Statements and
Required Supplemental Schedule**

Fiscal Year Ended June 30, 2011

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Net Assets
June 30, 2011

Assets	Governmental activities	Business-type activities	Total
Current assets:			
Cash in commercial banks	\$ 3,646,691	-	\$ 3,646,691
Accounts receivable, net of allowance for doubtful accounts:			
Taxes:			
Property taxes	1,009,994	-	1,009,994
Municipal license taxes	7,018	-	7,018
Construction excise taxes	14,542	-	14,542
Sales and use taxes	16,378	-	16,378
Intergovernmental grants and contributions	1,099,966	-	1,099,966
Restricted assets:			
Cash in commercial banks	3,048,463	77,184	3,125,647
Cash in fiscal agent	11,829,932	-	11,829,932
Accounts receivable:			
Property taxes receivable, net of allowance for doubtful accounts	6,193	-	6,193
Accrued interests on deposits	34,646	-	34,646
Intergovernmental grants and contributions	433,107	-	433,107
Other receivables	-	3,992	3,992
Other current assets	22,050	3,889	25,939
Total current assets	<u>21,168,980</u>	<u>85,065</u>	<u>21,254,045</u>
Non-current assets:			
Capital assets:			
Depreciable capital assets, net of accumulated depreciation of \$13,040,981 and \$ 3,239,760 for governmental and business-type activities, respectively	19,528,897	1,797,646	21,326,543
Non-depreciable capital assets	16,009,777	126,150	16,135,927
Other assets	-	431,677	431,677
Total non-current assets	<u>35,538,674</u>	<u>2,355,473</u>	<u>37,894,147</u>
Total assets	<u>\$ 56,707,654</u>	<u>2,440,538</u>	<u>\$ 59,148,192</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Net Assets (concluded)
June 30, 2011

Liabilities and net assets	Governmental activities	Business-type activities	Total
Current liabilities (due within one year):			
Accounts payable:			
Trade payables	\$ 847,479	23,967	\$ 871,446
Intergovernmental payables	1,188,345	-	1,188,345
Accrued liabilities:			
Accrued interests on bonds and notes payable	291,740	-	291,740
Unearned revenues	2,079,328	-	2,079,328
Current portion of long-term obligations:			
Bonds payable	370,000	-	370,000
Notes payable	34,088	81,678	115,766
Compensated absences	533,068	-	533,068
Total current liabilities	<u>5,344,048</u>	<u>105,645</u>	<u>5,449,693</u>
Non-current liabilities, excluding current portion (due in more than one year) :			
Bonds payable	14,186,616	-	14,186,616
Notes payable	90,519	783,530	874,049
Compensated absences	659,838	-	659,838
Other liabilities	-	19,285	19,285
Total non-current liabilities	<u>14,936,973</u>	<u>802,815</u>	<u>15,739,788</u>
Total liabilities	<u>20,281,021</u>	<u>908,460</u>	<u>21,189,481</u>
Net assets (liabilities):			
Invested in capital assets, net of related debt	<u>30,221,051</u>	<u>1,058,588</u>	<u>31,279,639</u>
Restricted for:			
Debt service	1,799,180		1,799,180
Capital projects	-	400,925	400,925
Other purposes	4,997,311	10,832	5,008,143
Total restricted	<u>6,796,491</u>	<u>411,757</u>	<u>7,208,248</u>
Unrestricted	(590,909)	61,733	(529,176)
Total net assets	<u>\$ 36,426,633</u>	<u>1,532,078</u>	<u>\$ 37,958,711</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Activities
Fiscal Year Ended June 30, 2011

Functions/programs	Expenses, including depreciation and amortization \$	Program revenues			Net revenues/ (expenses) and changes in net assets	Business-type activities	Total
		Charges for services	Program – specific operating grants and contributions	Program – specific capital grants and contributions			
Governmental activities:							
General government	\$ 3,769,822	74,495	1,852,587	795,168	\$ (1,047,572)	-	\$ (1,047,572)
Urban and economic development	5,411,768	-	-	735,672	(4,676,096)	-	(4,676,096)
Health and sanitation	359,544	-	-	-	(359,544)	-	(359,544)
Public safety	102,538	-	-	-	(102,538)	-	(102,538)
Public housing and welfare	797,549	-	533,920	-	(263,629)	-	(263,629)
Culture, recreation and education	1,184,632	-	-	-	(1,184,632)	-	(1,184,632)
Interests on long-term obligations	436,230	-	642,891	-	206,661	-	206,661
Total governmental activities	12,062,083	74,495	3,029,398	1,530,840	(7,427,350)	-	(7,427,350)
Business-type activities:							
Public housing and welfare, including interest on long-term obligations of \$55,844	550,362	2,357	545,336	-	-	(2,669)	(2,669)
Total business-type activities	\$ 550,362	2,357	545,336	-	\$ -	(2,669)	\$ (2,669)
General revenues:							
Taxes:							
Property taxes					\$ 2,733,968	-	\$ 2,733,968
Municipal license taxes					1,793,839	-	1,793,839
Construction excise taxes					332,059	-	332,059
Sales and use taxes					616,652	-	616,652
Total tax revenues					5,476,518	-	5,476,518
Intergovernmental grants and contributions, not restricted to specific programs					3,812,470	-	3,812,470
Interest on deposits					337,699	-	337,699
Miscellaneous					1,016,910	3,954	1,020,864
Total general revenues					10,643,597	3,954	10,647,551
Net increase in net assets					3,216,247	1,285	3,217,532
Net assets at beginning of fiscal year					36,546,465	1,530,793	38,077,258
Prior period adjustment					(3,336,079)		(3,336,079)
Net assets at beginning of fiscal year as restated					33,210,386	1,530,793	34,741,179
Net assets at end of fiscal year					\$ 36,426,633	\$ 1,532,078	\$ 37,958,711

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Balance Sheet – Governmental Funds
Fiscal Year Ended June 30, 2011

Assets	Major governmental funds						Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Special communities trust fund	Other governmental funds	
Cash in commercial banks, including cash equivalents	\$ 3,646,691	-	-	-	-	-	\$ 3,646,691
Accounts receivable, net of allowance for doubtful accounts							
Taxes:							
Property taxes	1,009,994	-	-	-	-	-	1,009,994
Municipal license taxes	7,018	-	-	-	-	-	7,018
Construction excise taxes	14,542	-	-	-	-	-	14,542
Sales and use taxes	16,378	-	-	-	-	-	16,378
Intergovernmental grants and contributions	1,099,966	-	-	-	-	-	1,099,966
Due from other governmental funds	624,952	-	-	-	-	-	624,952
Restricted assets:							
Cash in commercial banks	-	52,539	2,263,745	-	225,196	506,983	3,048,463
Cash in fiscal agent	-	9,095,341	-	2,404,744	-	329,847	11,829,932
Accrued interests on deposits	-	32,075	2,348	151	-	72	34,646
Due from other governmental funds	-	-	826,803	-	502	1,901,445	2,728,750
Intergovernmental grants and contributions	-	230,602	-	49,869	-	152,636	433,107
Property taxes receivable, net of reserve for doubtful accounts	-	-	-	6,193	-	-	6,193
Total assets	\$ 6,419,541	9,410,557	3,092,896	2,460,957	225,698	2,890,983	\$ 24,500,632
Liabilities							
Accounts payable and accrued liabilities:							
Trade payables and accrued liabilities	676,364	171,115	-	291,740	-	-	1,139,219
Intergovernmental payables	1,188,345	-	-	-	-	-	1,188,345
Due to other governmental funds	2,728,038	413,979	20,637	37	-	191,011	3,353,702
Deferred revenue	1,078,710	-	-	-	224,924	775,694	2,079,328
Matured bonds due and payable	-	-	-	370,000	-	-	370,000
Matured interest due and payable	-	-	-	-	-	-	-
Total liabilities	5,671,457	585,094	20,637	661,777	224,924	966,705	8,130,594
Fund balances							
Assigned	661,118	-	-	-	-	-	661,118
Unassigned	86,966	-	-	-	-	-	86,966
Restricted	-	8,825,463	3,072,259	1,799,180	774	1,924,278	15,621,954
Total fund balances (deficits)	748,084	8,825,463	3,072,259	1,799,180	774	1,924,278	16,370,038
Total liabilities and fund balances	\$ 6,419,541	9,410,557	3,092,896	2,460,957	225,698	2,890,983	\$ 24,500,632

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds
Fiscal Year Ended June 30, 2011

	Major governmental funds						Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Special communities trust fund	Other governmental funds	
Revenues:							
Taxes:							
Property taxes	\$ 2,244,807	-	-	489,161	-	-	\$ 2,733,968
Municipal license taxes	1,793,839	-	-	-	-	-	1,793,839
Construction excise taxes	332,059	-	-	-	-	-	332,059
Sales and use taxes	616,652	-	-	-	-	-	616,652
Total tax revenues	4,987,357	-	-	489,161	-	-	5,476,518
Intergovernmental grants and contributions	3,812,470	735,672	2,647,755	642,891	-	533,920	8,372,708
Interests on deposits	136,607	172,326	21,584	2,010	1,852	3,320	337,699
Charges for services	74,495	-	-	-	-	-	74,495
Miscellaneous	1,016,910	-	-	-	-	-	1,016,910
Total revenues	10,027,839	907,998	2,669,339	1,134,062	1,852	537,240	15,278,330
Expenditures:							
Current:							
General government	3,523,199	630	-	-	-	192,909	3,716,738
Urban and economic development	4,008,354	-	-	-	-	-	4,008,354
Health and sanitation	359,359	-	-	-	-	-	359,359
Public safety	99,590	-	-	-	-	-	99,590
Public housing and welfare	235,752	145,313	-	-	-	412,479	793,544
Culture, recreation and education	1,181,064	-	-	-	-	-	1,181,064
Debt service:	-	-	-	-	-	-	-
Debt issue costs	-	23,161	-	-	-	-	23,161
Principal	34,088	-	-	464,000	-	-	498,088
Interest	7,151	-	-	429,079	-	-	436,230
Capital outlays	491,571	923,537	815,805	-	-	-	2,230,913
Total expenditures	9,940,128	1,092,641	815,805	893,079	-	605,388	13,347,041
Excess (deficiency) of revenues over (under) expenditures)	87,711	(184,643)	1,853,534	240,983	1,852	(68,148)	1,931,289
Other financing sources (uses):							
Proceeds from issuance of bonds and notes	-	4,850,000	-	-	-	-	4,850,000
Transfers from other governmental funds	214,961	-	-	-	-	62	215,023
Transfers to other governmental funds	(62)	(212,821)	-	(699)	(1,078)	(363)	(215,023)
Total other financing sources (uses), net	214,899	4,637,179	-	(699)	(1,078)	(301)	4,850,000
Net increase (decrease) in fund balances	302,610	4,452,536	1,853,534	240,284	774	(68,449)	6,781,289
Fund balance at beginning of fiscal year							
	514,868	7,706,696	1,218,725	1,558,896	-	1,925,643	12,924,828
Prior-period adjustments							
	(69,394)	(3,333,769)	-	-	-	67,084	(3,336,079)
Fund balance at beginning of fiscal year, as restated							
	445,474	4,372,927	1,218,725	1,558,896	-	1,992,727	9,588,749
Fund balance at end of fiscal year	\$ 748,084	8,825,463	3,072,259	1,799,180	774	1,924,278	\$ 16,370,038

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

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF AIBONITO

Reconciliation of the Balance Sheet – Governmental Funds to Statement of Net Assets
June 30, 2011

	<u>Governmental activities</u>	<u>Business - type activities</u>	<u>Total</u>
<p>The amounts of governmental activities reported in the statement of net assets and the balance sheet – governmental funds, are different for the following reasons:</p>			
Total fund balances reported in the balance sheet – governmental funds	\$ 16,370,038	\$ 1,532,078	\$ 17,902,116
<p>Add (Deduct):</p>			
<p>Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of \$13,040,981 at June 30, 2011.</p>	35,538,674	-	35,538,674
<p>Debt issued by the Municipality has associated cost (debt issuance costs) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization of \$1,111.</p>	22,050	-	22,050
<p>The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2011:</p>			
Bonds payable	(14,186,616)	-	(14,186,616)
Notes payable	(124,607)	-	(124,607)
Compensated absences	(1,192,906)	-	(1,192,906)
Net assets – governmental activities, as reported in the statement of net assets	<u>\$ 36,426,633</u>	<u>1,532,078</u>	<u>\$ 37,958,711</u>

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

COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF AIBONITO

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances –
Governmental Funds to Statement of Activities

June 30, 2011

	<u>Governmental activities</u>	<u>Business - type activities</u>	<u>Total</u>
<p>The amounts of governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances (deficits) - governmental funds, are different for the following reasons:</p>			
Total net increase in fund balances reported in the statement of revenues, expenditures and changes in fund balances – governmental funds	\$ 6,781,289	1,285	\$ 6,782,574
Add (Deduct):			
Governmental funds report capital outlays (\$2,230,913) as expenditures. However in the statement of activities the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expense.	2,230,913	-	2,230,913
Governmental funds report the proceeds from the issuance of bonds (\$4,850,000) as other financial sources, however, such amounts are reported as an increase in bonds payable in the statement of net assets.	(4,850,000)	-	(4,850,000)
Governmental funds do not report depreciation expense (\$1,441,047) as expenditure, however, such amounts are reported in the statement of activities.	(1,441,047)	-	(1,441,047)
Repayment of principal of long-term obligations is reported as expenditure in the governmental funds; however, the repayment reduces long-term liabilities in the statement of net assets.	498,088	-	498,088
The following expenses reported in the statement of activities do not require the use of current available financial resources, therefore are not reported in the governmental funds:			
Net change in deferred charges (debt issue costs)	22,050	-	22,050
Net change in accrued compensated absences	(25,046)	-	(25,046)
Net increase (decrease) in net assets, as reported in statement of activities	<u>\$ 3,216,247</u>	<u>1,285</u>	<u>\$ 3,217,532</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Net Assets
Proprietary Fund
June 30, 2011

**Business-Type Activities -
Enterprise Fund**

**Las Flores Apartments
FmHA and Hud Project
No. 63-005-660-43-3572**

Restricted Assets

Current assets:

Restricted assets:

Cash in commercial banks	\$	77,184
Tenants accounts receivable		3,992
Other assets		3,889
Total current assets		85,065

Non-current assets:

Depreciable capital assets, net of accumulated depreciation of \$3,239,760		1,797,646
Non-depreciable capital assets		126,150
Total capital assets		1,923,796
Other assets		431,677
Total non-current assets		2,355,473
Total assets	\$	2,440,538

Liabilities and fund net assets

Current liabilities (due within one year):

Accounts payables and accrued liabilities, including accrued interests of \$...	\$	23,967
Current portion of mortgage notes payable		81,678
Total current liabilities		105,645

Non-current liabilities, excluding current portion

Tenants' security deposits		19,285
Mortgage notes payable – due in more than one year		783,530
Total non-current liabilities		802,815
Total liabilities		908,460

Fund net assets:

Invested in capital assets, net of related debt		1,058,588
Restricted for:		
Capital projects		400,925
Other purposes		10,832
Total restricted		411,757
Unrestricted		61,733
Total net assets	\$	1,532,078

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Statement of Revenues, Expenses and Changes in Net Assets
 Proprietary Fund
 Fiscal Year Ended June 30, 2011

	Business-Type Activities - Enterprise Fund
	Las Flores Apartments FmHA and HUD Project <u>No. 63-005-660-43-3572</u>
Operating revenues:	
Charges for services – rental income from tenants	\$ 2,357
Intergovernmental grants and contributions – tenants assistance payments from U.S. Department of Housing and Urban Development	545,336
Miscellaneous	3,954
Total operating revenues	551,647
Operating expenses:	
General and administrative	171,042
Utilities	7,124
Maintenance	106,640
Insurance	40,534
Interest on mortgage notes payable	55,844
Depreciation of capital assets	169,178
Total operating expenses	550,362
Operating income	1,285
Net assets at beginning of fiscal year	1,530,793
Net assets at end of fiscal year	\$ 1,532,078

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Cash Flows
Proprietary Fund
Fiscal Year Ended June 30, 2011

**Business-Type Activities -
Enterprise Fund**

**Las Flores Apartments
FmHA and HUD Project
No. 63-005-660-43-3572**

Cash flows from operating activities:

Net decrease in net assets	\$	1,285
Depreciation expense		169,178
Increase in accounts receivable – tenants, net		(1,560)
Decrease in prepaid insurance		197
Increase in deposit held by trust		(417)
Decrease in accounts payable and accrued expenses		(7,949)
Decrease in accrued interest		(5,335)
Increase in deposit tenants security		417
Net cash provided by operating activities		<u>155,816</u>

Cash flows from investing activities:

Increase in reserve for replacement		(5,859)
Increase in escrow account		(4,560)
Increase in building improvements		(600)
Increase in building equipment		(4,862)
Increase in office equipment		(3,655)
Net cash used in investing activities		<u>(19,536)</u>

Cash flows from financing activities:

Decrease in mortgage payable		(78,674)
Net cash used by financing activities		<u>(78,674)</u>

Net decrease in cash 57,606

Cash in commercial banks at beginning of year 19,578

Cash in commercial banks at end of year \$ 77,184

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

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
Notes to Financial Statements
June 30, 2011

1. Summary of Significant Accounting Policies

The Municipality of Aibonito, Commonwealth of Puerto Rico (the Municipality), is a local municipal government constituted in 1824 in the Commonwealth of Puerto Rico. The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Law No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipal governments legally separated from the state government of the Commonwealth of Puerto Rico (the Commonwealth).

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

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

a) *Financial Reporting Model*

The accompanying basic financial statements present the financial position of the governmental activities, the business-type activities, each major governmental and proprietary funds, and the aggregate remaining fund information of the Municipality at June 30, 2011, in conformity with Accounting Principles Generally Accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). In addition, the accompanying basic financial statements present the changes in the financial position (results of operations) of the governmental activities, the business-type activities, each major governmental and proprietary funds, and the aggregate remaining fund information for the fiscal year ended June 30, 2011, in conformity with GAAP. Furthermore, the basic financial statements referred to above present the cash flows of the business-type activities (proprietary fund) for the fiscal year ended June 30, 2011 in conformity with GAAP.

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the required basic financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental and proprietary fund financial statements (FFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

MUNICIPALITY OF AIBONITO
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June 30, 2011

RSI consists of: (1) a Management's Discussion and Analysis (MD&A) and (2) a budgetary comparison schedule – general fund. *RSI* is unaudited supplementary information required by GAAP presented along with, but separate from, the Municipality's basic financial statements.

MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2011, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The *MD&A* also highlights certain key fiscal policies that control the Municipality's operations.

In addition to the required financial reporting requirements referred to above, the accompanying basic financial statements are accompanied by additional supplementary information consisting of a budgetary comparison schedule – debt service fund and the notes to the budgetary comparison schedule – debt service fund, which have been subjected to the auditing procedures applied in the audit of the accompanying basic financial statements as of and for the fiscal year ended June 30, 2011.

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

GASB 55 incorporated the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board's (GASB) authoritative literature. The requirements in this Statement codify all GAAP for state and local governments so that they derive from a single source.

GASB 56 incorporated into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This Statement addressed three issues not included in the authoritative literature that establishes *accounting* principles—related party transactions, going concern considerations, and subsequent events.

The adoption of GASB 55 and GASB 56 did not have retroactive cumulative effects affecting the accompanying financial statements as of July 1, 2009, and have not affected the financial positions and the results of operations reported as of and for the fiscal year ended June 30, 2011. Accordingly, the accompanying GFFS have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2010.

b) *Financial Reporting Entity*

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the

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Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance, as prescribed by Act No. 81.

The accompanying basic financial statements include the financial statements of Las Flores Apartments (FmHA and HUD Project No. 63-005-660-43-3572), an operational unit and a business-type activity (proprietary fund) of the Municipality which single audit report reflect total assets, liabilities, net assets, revenues and expenses of \$2,440,538, \$908,460, \$1,532,078, \$551,647 and \$550,362, respectively, as of and for the fiscal year ended June 30, 2011. The financial position, results of operations and cash flows of Las Flores Apartments as of and for the fiscal year ended June 30, 2011 are reported in the accompanying statement of net assets – proprietary fund, the statement of revenues, expenses and changes in fund net assets – proprietary fund, and the statement of cash flows – proprietary fund, respectively.

Las Flores Apartments is a housing development project consisting of one-hundred (100) dwelling units located in Aibonito. The project is owned by the Municipality, but its operations are carried out by a private management agent unrelated to the Municipality. The housing development project of Las Flores Apartments has been designed to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operates under financing through the Section 8 Housing Assistance Program of the U.S. Department of Housing and Urban Development. The purpose of Las Flores Apartments is to provide adequate housing to low-income residents of the Municipality. Separate audited financial statements of Las Flores Apartments can be obtained directly from the management agent's offices at Villa Nevares Professional Center, Suite 302, San Juan, Puerto Rico 00927.

On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

According to GASB No. 39, a legally separate, tax-exempt organization should be reported as a discretely presented component unit of a reporting entity if all of the following criteria are met:

- 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.
- 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.

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- 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 that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14. The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2011.

c) *Government-Wide Financial Statements*

The accompanying GWFS are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements report information of all governmental and business-type activities of the Municipality as a whole. These statements are aimed at presenting a broad overview of the Municipality's finances by reporting its financial position and results of operations using methods that are similar to those used by most private businesses.

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity) and/or net liabilities (accumulated deficit). This statement assists management in assessing the level of services that can be provided by the Municipality in the future and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets and discloses legal and contractual restrictions on resources.

Net assets (liabilities) are classified in the accompanying statement of net assets within the following three categories:

- **Invested in capital assets, net of related debt** – This net asset category consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital

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assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.

- **Restricted net assets** – This net asset category consists of net resources restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

On July 1, 2005, the Municipality adopted the provisions of Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement clarified that a legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. This Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration. Although the determination that a particular restriction is not legally enforceable may cause the Municipality to review the enforceability of other restrictions, it should not necessarily lead the Municipality to the same conclusion for all enabling legislation restrictions.

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

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

The Municipality has reported the following types of restricted net assets in the accompanying statement of net assets:

- (1) **Debt service** – Represent net resources available to cover future debt service payments of bonds payable.
- (2) **Capital projects** – Represent net resources available to carry out several capital project funds and the acquisition of capital assets.

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- (3) **Other purposes** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs.
- **Unrestricted** – This category consists of the excess of liabilities over related assets (accumulated deficit) that are neither externally nor legally restricted, neither invested in capital assets. However, assets reported within unrestricted net liabilities often are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified. When both restricted and unrestricted resources are available for use, it is the Municipality's policy to generally use restricted resources first, and then unrestricted resources as they are needed.

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net assets or liabilities changed during the fiscal year ended June 30, 2011, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

- Municipal legislature
- Mayor's office
- Department of finance
- Department of human resources
- Department of municipal secretary
- Department of internal audit
- Office of communications
- Office of administrative services

Urban and economic development:

- Department of public works
- Department of planning and development

Public safety:

- Department of emergency management – civil defense
- Department of municipal police
- Department of sanitation

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Health and sanitation:

Department of recycling services
Municipal enterprises
Department of health

Culture, recreation and education:

Department of sports and recreation
Department of art, culture and tourism

Public housing and welfare:

Department of citizen affairs

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in three broad categories: (1) program revenues, (2) general revenues and (3) special items.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at: (1) the net cost of the function/program that must be financed from the Municipality's general revenues or (2) the net program revenue that contributes to the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, rent, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific operating and capital grants and contributions** – These revenues consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal

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license taxes and construction excise taxes are reported as general revenues. All other nontax revenues (including unrestricted interest on deposits, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

Special items consist of revenues arising from significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence.

Extraordinary items consist of revenues arising from significant transactions or other events that are both unusual in nature and infrequent in occurrence.

The *general government* function/program reported in the accompanying statement of activities includes expenses that are, in essence, indirect or costs of other functions/programs of the Municipality. Even though some of these costs have been charged to certain funds in the FFS as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect costs as direct expenses of the general government function. Accordingly, the Municipality generally does not allocate general government (indirect) costs to other functions.

The effects of all inter-fund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies the most significant portion of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the FFS. On the other hand, the operations of Las Flores Apartments are reported as business-type activities in the accompanying GWFS. These activities are primarily financed from grants and contributions and charges for services. These business-type activities are also reported in the FFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements.

The Municipality has operations and activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; and where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

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d) *Fund Financial Statements*

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

The accompanying FFS are composed of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds, (3) the statement of net assets – proprietary fund, (4) the statement of revenues, expenses and changes in fund net assets – proprietary fund, and (5) the statement of cash flows – proprietary fund.

These financial statements report the financial position and results operations of the Municipality's governmental and proprietary funds and fund types by presenting sources, uses and balances of current and noncurrent financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major governmental fund and fund types, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current fiscal year have complied with public decisions concerning the raising and spending of public moneys in the short term (generally one fiscal year).

The accompanying FFS segregate governmental funds, proprietary funds and fund types according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds and fund types is maintained consistent with legal and self-imposed managerial requirements established by the Municipality.

On July 1, 2010, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54), which modified the interpretations of certain terms within the definition of the special revenue funds and the types of activities the Municipality may choose to report in those funds. GASB 54 also clarified the capital projects fund type definition for better alignment with the needs of preparers and users. Definitions of other governmental fund types also were also modified for clarity and consistency. Pursuant to the provisions set forth by GASB 54, the Municipality reported the following types of governmental funds in the accompanying GFFS:

- ***General fund*** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

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- ***Debt service fund*** – The debt service fund is a major governmental fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. During the fiscal year ended June 30, 2011, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

The outstanding balance of general long-term obligations for which debt service payments do not involve the advance accumulation of resources (such as notes payable and obligations under capital leases) are only accounted for in the accompanying statement of net assets. The debt service payments of such debts, as applicable, are generally accounted for as debt service – principal and debt service – interest expenditures in the general fund.

- ***Capital projects funds*** – Capital projects funds are major and non-major governmental funds, as defined below, used to account for the financial resources used for the acquisition, construction or improvement of major capital facilities and other assets. Significant capital outlays financed from proceeds of general obligation, public improvement or special obligation bonds accounted for also in the capital projects funds.

The use of the capital projects funds has been reserved only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund from which financial resources were used for the payment.

- ***Special revenue funds*** – The special revenue funds are non-major governmental funds, as defined below, used by the Municipality to account for revenues derived from grants, contributions or other revenue sources that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in major capital projects which are accounted for in the capital project funds). The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.
- ***Proprietary fund*** – Proprietary fund is an enterprise fund used to report the financial position, results of operation and cash flows of Las Flores Apartments (FHA and

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HUD Project No. 63-005-660-43-3572), which are activities for which the intent of management is to recover, partially through user charges for services (rent) and mostly through federal grants, the cost of low-income housing services to the general public.

The activities of Las Flores Apartments have been reported as a proprietary fund as GAAP permits the use of enterprise funds to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees or user charges (GASB No. 34, paragraph 67).

The focus of the FFS is on major governmental funds, proprietary funds and fund types, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds, proprietary funds and fund types between major and non-major categories within the FFS. Major individual governmental and proprietary funds and fund types are reported individually as separate columns in the FFS, while data from all non-major governmental and proprietary funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund is classified as a major governmental fund in the FFS if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. In addition, the same element that meets the 10 percent criterion must be at least 5 percent of the corresponding element total for all governmental and enterprise (proprietary) funds combined. For the purposes of applying the aforementioned major fund criteria, no eliminations of inter-fund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures\expenses for these purposes mean all expenditures\expenses, including operating and non-operating expenditures\expenses, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying FFS are: (1) the general fund, (2) the debt service fund, (3) the capital project fund, (4) the legislative joint resolutions fund and (5) the special communities trust fund. In addition, Las Flores Apartments has been reported separately from governmental funds as the only proprietary fund of the Municipality.

The legislative joint resolutions fund is a major governmental fund, as defined below, used by the Municipality to account for revenues derived from state legislative assignments and contributions that are legally restricted for a wide range of community development activities directed toward revitalizing neighborhoods, economic development, and providing improved community facilities and services.

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The special communities trust fund is a major governmental fund, created and used to account for the Commonwealth of Puerto Rico Special Communities Program's funds held in trust.

As required by GASB No. 34, the proprietary fund of the Municipality applies all pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB) and the Committee on Accounting Procedure, issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict the standards of the Governmental Accounting Standards Board. However, the Municipality has elected to continue following more recent FASB guidance, provided it neither conflicts nor contradicts GASB pronouncements.

The accompanying FFS are accompanied by other statements and schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net assets, and (2) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities.

e) *Measurement Focus and Basis of Accounting*

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

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include certain charges for services and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non-exchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax

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revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

Proprietary funds distinguish operating revenue and expenses from non-operating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as non-operating revenue and expenses. The major operating revenue of the Municipality's enterprise fund is from rent charges collected principally from a Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with U.S. Department of Housing and Urban Development.

In the case of derived tax revenue transactions, which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

In the case of imposed non-exchange revenue transactions (such as property taxes and municipal license taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to the Municipality and the provider government requires the Municipality to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above. Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

According to GASB No. 34, all general capital assets and the un-matured long-term liabilities are recorded only in the accompanying statement of net assets and the statement of net assets – proprietary fund. The measurement focus and the basis of

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accounting used in the accompanying GWFS and the proprietary fund differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying governmental fund financial statements. Therefore, the accompanying governmental fund financial statements include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the governmental fund financial statements.

Governmental fund financial statements – The accompanying governmental fund financial statements are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances (deficits) – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality considers most revenues to be available if collected generally within 90 days after June 30, 2011, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred (earned and unavailable) revenues at June 30, 2011.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, construction excise taxes, intergovernmental grants and contributions, interest on deposits and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying governmental fund financial statements, except for amounts recorded as deferred (earned and unavailable) revenues.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed previously, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, certain charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred for expenditure-driven grants).

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Interest on deposits is recorded when earned only if collected within 90 days after the fiscal year-end since these revenues would be considered both measurable and available. Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and an expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated with current available financial resources. GASBI No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34, and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities. Therefore, the accompanying balance sheet – governmental funds generally reflects assets that will be converted into cash to satisfy current liabilities. Long-term assets (except for accounts receivables and inter-fund advances) and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

Modifications to the accrual basis of accounting in accordance with GASBI No. 6 include:

- Principal and interest on bonds payable are recorded when they mature (when payment is due), except for principal and interest due on July 1, 2011, which have been recorded as governmental fund liabilities at June 30, 2011, which is the date when resources are available in the debt service fund (generally, June 30).
- Notes payable, obligations under capital leases, compensated absences, and amounts subject to accrued claims and judgments under litigation are recorded only when they mature (when payment is due).
- Certain accrued liabilities not due and payable or not normally expected to be liquidated with current available and expendable financial resources are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the governmental funds FFS.

The measurement focus of the governmental funds financial statements is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying statement of activities and the statement of revenues, expenses and

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changes in fund net assets, but are not recorded in the accompanying governmental fund financial statements.

f) *Stewardship, Compliance and Accountability*

Budgetary Control

According to Law No. 81, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budgets are prepared.

The Mayor must submit, for each fiscal year commencing on July 1, an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of the Commonwealth (the Commissioner) and the Municipal Legislature no later than the immediately preceding May 10 and May 15, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before the immediately preceding June 13.

The Municipal Legislature has 10 business days, up to the immediately preceding June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to eight (8) days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This regulation permits the Municipality to continue doing payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as fiscal year-end encumbrances, and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

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The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds. The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the function/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Budgetary Accounting

The Municipality's annual budgets are prepared using the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

According to the budgetary basis of accounting, revenue is generally recorded when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one fiscal year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at fiscal year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying budgetary comparison schedule – general fund provides information about the general fund's original budget, its amendments, and the actual results of operations of such major governmental fund under the budgetary basis of accounting for the fiscal year ended June 30, 2011. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2011, which is prepared by the Municipality's Department of Finance. Copies of that report may be obtained by writing to the Municipality's Director of Finance.

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Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general and debt service funds' budgetary bases and GAAP actual amounts are presented at the bottom of the respective budgetary comparison schedules.

g) *Unrestricted and Restricted Deposits*

The Municipality's deposits are composed of: (1) cash on hand, (2) demand deposits in commercial banks, and (3) demand deposits in the Government Development Bank for Puerto Rico (fiscal agent).

Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). Agents designated by the Commonwealth's Secretary of the Treasury, but not in the Municipality's name hold all securities pledged as collateral.

Cash in fiscal agent in the debt service fund consists of cash related to property tax collections amounting to \$2,404,744, which is restricted for the payment of the Municipality's debt service, as required by law. Cash in fiscal agent in the capital projects fund, amounting to \$9,095,341 consists mainly of unspent proceeds of bonds, which are restricted for the acquisition, construction or improvement of capital assets. Cash in fiscal agent of other governmental funds, amounting to \$329,847 represents mainly the balance of interest and non-interest bearing accounts restricted to finance the operations of certain federal and state funded programs.

Restricted cash in commercial banks, amounting to \$52,539 in capital projects fund represents mainly the balance of interest and non-interest bearing accounts restricted to finance the operations of certain federal and state funded programs.

Restricted cash in commercial banks, amounting to \$2,263,745 in the legislative joint resolutions fund represents mainly the balance of interest and non-interest bearing accounts restricted to finance the operations of certain operating and capital grants from the Legislature of the Commonwealth of Puerto Rico.

Restricted cash in commercial banks, amounting to \$225,196 in the special communities trust fund represents mainly the balance of interest and non-interest bearing accounts restricted to finance the operations of a state funded program used to carry out permanent capital improvements to various communities in Aibonito.

Restricted cash in commercial banks, amounting to \$506,983 in other governmental funds represents mainly the balance of interest and non-interest bearing accounts restricted to finance the operations of certain state-funded and federally-funded operating and capital grants.

Restricted cash in commercial banks of Las Flores Apartments (proprietary fund), amounting to \$77,184, represents the balance of interest and non-interest bearing

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accounts restricted to finance the project operations. Las Flores Apartments is required to set amounts for the replacement of property and other project expenditures, as approved by the U.S. Department of Housing and Urban Development. Accordingly, the restricted cash balances of Las Flores Apartments include a replacement reserve of \$27,702.

h) *Unrestricted and Restricted Accounts Receivable*

Accounts receivable consist of all revenues earned but not collected at June 30, 2011. These accounts receivables are stated net of estimated reserved for doubtful accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

Activities among governmental funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of inter-fund loans) or "advances to/from other funds" (i.e., the non-current portion of inter-fund loans), as applicable. All other outstanding balances between funds are reported as "due to/from other funds."

i) *Capital Assets*

Capital assets used in governmental and business-type activities include land and land improvements, buildings, structures and building improvements, machinery and equipment (including equipment held under capital leases), furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets and the statement of net assets – proprietary fund. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost basis of \$25 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under \$25 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities and the statement of revenues, expenses and changes in fund net assets. In the governmental funds, all capital assets are recorded as capital outlays (expenditures), while all assets with individual costs under \$25 are recorded as expenditures in the corresponding function/program identified with the asset.

In the statement of net assets and the statement of net assets – proprietary fund, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a portion of the infrastructure constructed or acquired prior to June 30, 2003 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June

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30, 2003 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

Major outlays for capital assets and improvements are capitalized in the statement of net assets as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Motor vehicles	5
Furniture, fixtures, machinery and equipment, excluding those held under capital leases	5 to 20
Office equipment held under capital leases	3 to 5

Depreciation and amortization expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but reported as direct expenses of the urban and economic development function.

j) *Deferred Revenues*

In the governmental fund financial statements, deferred revenue arises when one of the following situations occur:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (reported as “*earned and unavailable revenue*” in the accompanying balance sheet-governmental funds). As previously discussed, available is defined as due (or past due) at June 30, 2011 and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria (measurable and available) are met, the liability for deferred revenue is removed and revenue is recognized.
- The Municipality receives resources before it has a legal claim to them (reported as “*unearned revenue*” in the accompanying balance sheet-governmental funds). In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

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Unearned revenues at the government-wide and the proprietary fund levels arise only when the Municipality receives resources before it has a legal claim to them (reported as “*unearned revenue*” in the accompanying statement of net assets). No “*earned and unavailable revenue*” is accounted for in the accompanying statement of net assets nor the statement of net assets – proprietary fund.

k) *Compensated Absences*

The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2011 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of social security taxes and medicare taxes).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per fiscal year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per fiscal year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each fiscal year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each fiscal year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. In addition upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed previously. After 10 years of services, any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

The liability for compensated absences is in the statement of net assets. A liability for compensated absences is reported in the governmental fund financial statements only when matured (when payment is due), for example, as a result of employee resignations or retirements.

l) *Long-term Debt*

The long-term liabilities reported in the accompanying statements of net assets include the Municipality’s bonds payable, notes payable, and accrued compensated absences.

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All long-term debts to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due on July 1, 2011 have been recorded as governmental fund liabilities in the debt service fund at June 30, 2011, when resources were available. In the governmental fund financial statements, the face amount of debt issued (gross debt proceeds) is reported as other financing sources when issued.

In the governmental activities of the GWFS, debt issuance costs have been capitalized and reported as deferred charges, which are being amortized under the straight-line method over the respective lives of the debts. In the GFFS, such costs are recorded as expenditures as incurred.

Non-interest bearing notes payable are accounted for under the provisions of Opinion No. 21, *Interest on Receivables and Payables*, issued by the Accounting Principles Board (APB No. 21). According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The discount is amortized over the life of the notes using the effective interest method. Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses as incurred.

m) *Accounting for Pension Costs*

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth of Puerto Rico. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico report the total amount of the net pension obligation of ERS, including any amount that may correspond to the Municipality.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

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n) *Risk Management*

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each fiscal year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center ("CRIM", by its Spanish acronym), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (ACAA, by its Spanish acronym), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium applicable at June 30, 2011 is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth. 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. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). 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 DOL on a cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2011. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

o) *Fund Balances*

On July 1, 2010, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which

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the Municipality is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB 54, the accompanying GFFS report fund balance amounts that are considered nonspendable, such as fund balance associated with inventories. Other fund balances have been reported as restricted, committed, assigned, and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- a. *Nonspendable* - Represent resources that cannot be spent readily with cash or are legally or contractually required not to be spent, including but not limited to inventories, prepaid items, and long term balances of interfund loans and accounts receivable.
- b. *Restricted* - Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
- c. *Committed* - Represent resources used for specific purposes, imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution.
- d. *Assigned* - Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- e. *Unassigned* - Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Negative fund balance amounts are assigned amounts reduced to the amount that will raise the fund balance to zero. Consequently, negative residual amounts in restricted, committed and assigned fund balance classifications have been reclassified to unassigned fund balances.

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

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resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2011.

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

The classification of the Municipality's individual governmental funds among general, debt service, special revenue and capital project fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB 54. In addition, the financial positions and the results of operations reported in the accompanying GFFS as of and for the fiscal year ended June 30, 2011 have not been affected for this change in accounting principle. Accordingly, the accompanying GFFS have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2010.

p) *Inter-fund Activities*

The Municipality has the following types of reciprocal and non-reciprocal inter-fund activities recorded among governmental funds in the accompanying FFS:

- ***Inter-fund loans*** – Represent resources (assets) provided by one governmental fund to other governmental fund with a requirement and commitment for repayment (reimbursement), which are recorded as “*due from*” in the lender governmental fund and “*due to*” in the borrower governmental fund. Inter-fund receivables, which are not considered to be currently available financial resources, are reported as “*advances*”. For amounts not expected to be collected, inter-fund receivables/payables are reduced to their estimated realizable (settlement) value, and the portion of the inter-fund loan that is not expected to be repaid is reported as a “*transfer-in*” from the governmental fund that provided the loan.
- ***Inter-fund transfers (transfers-in/(out))*** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as “*other financing uses*” in the governmental fund making transfers and as “*other financing sources*” in the governmental fund receiving transfers.
- ***Inter-fund reimbursements*** – Represent repayments (reimbursements) from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the FFS, inter-fund activity has not been eliminated, as permitted by GAAP.

q) *Use of Estimates*

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect

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the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

r) *Future Adoption of Accounting Pronouncements*

The GASB has issued the following statements that have effective dates after June 30, 2011:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (GASB 60). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2011.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2012.

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

2. Deposits

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

On July 1, 2004, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly, the Municipality is only allowed to invest its obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2011.
- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its

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exposure to declines in fair values by: (1) not including debt investments in its investments portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments to periods of three months or less and (3) keeping most of its banks deposits in interest bearing accounts generating interest at prevailing market rates. At June 30, 2011, the interest rate risk associated with the Municipality's cash.

- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB, amounting to \$11,829,932 at June 30, 2011, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2011. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2011, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2011.

Cash and cash equivalents at June 30, 2011, are classified in the accompanying balance sheet – governmental funds as follows:

3. Municipal License Taxes

The Municipality is authorized by Act No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Aibonito. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2011, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess the corresponding municipal license tax by declaring the volume of business through a tax return filed every April 15, based on the actual volume of business

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(revenues) earned in the preceding calendar year. Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax return filings. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration on April 15. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5 percent discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as unearned revenues in the GWFS and the GFFS. Total municipal license tax receivable amounted to \$7,018 at June 30, 2011. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$2,079,328 at June 30, 2011.

4. Property Taxes

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1 of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business or (2) owns residential real property with a value in excess of \$15,000 (at 1957 estimated market prices).

CRIM is responsible for the billings and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs to the Municipality the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the fiscal year, CRIM advances funds to the Municipality based on the initial estimated collection amounts for the fiscal year. 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 the property tax amounts actually collected from taxpayers on behalf of the Municipality during the fiscal year. This settlement has to be completed on a preliminary basis not later than December 31 following the fiscal year end.

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2011 was 6.00 percent (of which taxpayers pay 5.80 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property, deflated to 1957 market prices. The total real property tax rate in force at June 30, 2011 was 8.00 percent (of which 7.80 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

Residential real property occupied by its owner (not engaged in trade or business) is exempt from property taxes only on the first \$15,000 of the assessed value (at 1957 market prices). For exempt amounts, the Department of Treasury assumes the payment of the basic tax (4.00

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percent and 6.00 percent for personal and real property, respectively), except for property assessed for less than \$3,500 (at 1957 market prices), for which no payment is made by the Department of Treasury.

According to Act No. 81, included within the total personal and real property tax rates of 5.80 percent and 7.80 percent, respectively, there is a levy of an annual special tax of 1.03 percent of the assessed value of all real and personal property not exonerated from taxation. This special tax is levied by the Commonwealth but is collected by CRIM. Collections of this special tax are directly remitted by CRIM to the Commonwealth's debt service fund, for the payment of the general long-term debt of the Commonwealth.

In addition, included within the total personal and real property tax rates of 5.80 percent and 7.80 percent, respectively, there is a portion of the tax rate in the amount of 2.00 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

Furthermore, included within the total personal and real property tax rates of 5.80 percent and 7.80 percent, respectively, there is a portion of the tax rates that is recorded in the Municipality's general fund, of which a portion is restricted for the payment of: (1) the insurance premiums acquired through the Department of Treasury, (2) the monthly contributions to CRIM, which are statutorily required as the Municipality's share of CRIM operating expenses, (4) statutory contributions to the Puerto Rico Health Services Administration (PRHSA), as the Municipality's share of the cost of the public health insurance coverage provided to qualifying low-income citizens, (5) certain notes payable to CRIM and, (6) certain amounts due to certain agencies and component units of the Commonwealth, which are recorded within intergovernmental payables in the accompanying GWFS and GFFS. The 0.20 percent of unrestricted personal and real property taxes paid by the Department of Treasury as a subsidy is recorded in the Municipality's general fund.

The Additional Lottery System of the Commonwealth (the Additional Lottery) is an operational unit reported as an enterprise fund in the Commonwealth's basic financial statements, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every fiscal year to distribute a portion of its excess of revenues over expenses as follows:

- Thirty five percent of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the thirty-five percent corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to PRHSA.

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At June 30, 2011, property taxes receivable recorded in the general and debt service fund amounted to \$ 1,009,994 and \$ 6,193, respectively, net of a reserve for doubtful accounts.

5. Sales and Use Taxes

The Municipality imposes a sales and usage tax within the territorial limits of the Municipality pursuant to the Internal Revenue Code of the Government of Puerto Rico. This is a self-assessed tax consisting of one and a half percent (1.5%) on the sale price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item. It is collected monthly in a tax return that is due twenty calendar days after the end of each month.

A portion of the sales tax amounting 0.2% is restricted for the payment of long-term debt and is recorded in the debt service fund. The remaining portion of 1.3% is recorded in the general fund since is available for general operating purposes.

Sale tax receivable represents sales tax levied that were collected subsequent to June 30, 2010, but pertaining to current year period. At June 30, 2011, the sales and use taxes receivable amounted to \$16,378.

6. Construction Excise Taxes

The Municipality imposes and collects municipal construction excise taxes to most natural and legal persons and any governmental instrumentality that carry out activities related to construction, expansion, major repairs, relocations, alterations and other types of permanent improvements to residential, commercial and industrial buildings and structures within the territorial area of the Municipality. The tax is also applicable to infrastructure projects, the installation of machinery, equipment and fixtures, and other types of construction-related activities.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, project design and other engineering fees, licenses and permits, legal and accounting fees, and most marketing and advertising costs. The tax is paid by the taxpayer at the beginning of the project.

All single-family residential construction projects not related to housing development projects, condominiums, or any similar projects, are partially exempt from construction excise taxes. In addition, a portion of all single-family residential improvement projects are exempt from construction excise taxes. All projects carried out on buildings and structures classified as historical treasures by the Puerto Rico Planning Board have an in the tax rate applicable to construction excise taxes.

Construction excise tax receivable represents taxes that were collected subsequent to June 30, 2011, but pertaining to current year period. At June 30, 2011, the construction excise taxes receivable amounted to \$14,542.

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7. Inter-fund Transactions

The composition of inter-fund balances at June 30, 2011 and for the fiscal year then ended is as follows:

	<i>Due to:</i>					Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	
<i>Due from:</i>						
Major governmental funds:						
General fund	\$ -	\$ 413,267	\$ 20,637	\$ 37	\$ 191,011	\$ 624,952
Legislative joint resolutions fund	826,803	-	-	-	-	826,803
Special communities trust fund	502	-	-	-	-	502
Other governmental funds	1,900,733	712	-	-	-	1,901,445
Total	\$ 2,728,038	\$ 413,979	\$ 20,637	\$ 37	\$ 191,011	\$ 3,353,702

	<i>Transfer from other funds:</i>				Total governmental funds
	General fund	Capital projects fund	Debt service fund	Other governmental funds	
<i>Transfer to other funds:</i>					
Major governmental funds:					
General fund	\$ -	\$ -	\$ -	\$ -	\$ -
Capital projects fund	212,821	-	-	-	212,821
Debt service fund	699	-	-	-	699
Special communities trust fund	1,078	-	-	-	1,078
Other governmental funds	363	-	-	62	425
Total	\$ 214,961	\$ -	\$ -	\$ 62	\$ 215,023

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8. Capital Assets

Capital assets activity for the fiscal year ended June 30, 2011 is as follows:

	Balance at June 30,2010	Additions	Reclassifications	Balance at June 30,2011
<u>COST BASIS:</u>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Infrastructure land	\$ 15,357,537	\$ -	\$ -	\$ 15,357,537
Construction in progress	526,839	358,414	(233,013)	652,240
Total cost basis of capital assets, not subject to depreciation and amortization	<u>15,884,376</u>	<u>358,414</u>	<u>(233,013)</u>	<u>16,009,777</u>
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	10,121,055	-	-	10,121,055
Infrastructure	16,514,495	1,802,612	233,013	18,550,120
Land Improvements	-	-	-	-
Licensed vehicles	2,977,203	-	-	2,977,203
Furniture, fixtures, machinery and equipment	851,613	69,887	-	921,500
Total cost basis of capital assets subject to depreciation and amortization	<u>30,464,366</u>	<u>1,872,499</u>	<u>233,013</u>	<u>32,569,878</u>
Total cost basis of capital assets	<u>\$ 46,348,742</u>	<u>\$ 2,230,913</u>	<u>\$ -</u>	<u>\$ 48,579,655</u>
	Balance at June 30,2010	Depreciation and Amortization Expense	Reclassifications	Balance at June 30,2011
<u>ACCUMULATED DEPRECIATION AND AMORTIZATION:</u>				
Buildings, structures and building improvements	\$ 4,107,637	\$ 446,886	\$ -	\$ 4,554,523
Infrastructure	4,243,011	616,657	-	4,859,668
Land Improvements	-	-	-	-
Licensed vehicles	2,584,639	278,309	-	2,862,948
Furniture, fixtures, machinery and equipment	664,647	99,195	-	763,842
Total accumulated depreciation and amortization	<u>11,599,934</u>	<u>1,441,047</u>	<u>-</u>	<u>13,040,981</u>
CAPITAL ASSETS, NET	<u>\$ 34,748,808</u>	<u>\$ 789,866</u>	<u>\$ -</u>	<u>\$ 35,538,674</u>

a) **Governmental Activities**

Depreciation and amortization expense of governmental activities for the fiscal year ended June 30, 2011 was charged to functions/programs in the accompanying statement of activities as follows:

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	Total depreciation expense
General government	\$ 42,270
Public safety	2,522
Public housing and welfare	2,215
Urban and economic development	1,393,518
Culture, recreation and education	522
Total depreciation and amortization expenses	\$ 1,441,047

b) Business-type Activities

	Cost basis at beginning of fiscal year	Additions	Cost basis at end of fiscal year
<i>Business-type activities:</i>			
<i>Cost basis:</i>			
Capital assets, not being depreciated - land	\$ 126,150	-	\$ 126,150
Total capital assets, not being depreciated	126,150	-	126,150
Capital assets, being depreciated:			
Buildings, structures, and improvements	4,344,828	599	4,345,427
Land improvements	267,559	-	267,559
Machinery and equipment, and furniture and fixtures	415,902	8,518	424,420
Total capital assets, being depreciated	5,028,289	9,117	5,037,406
Total cost basis of capital assets	\$ 5,154,439	9,117	\$ 5,163,556
Accumulated depreciation and amortization:			
	Accumulated depreciation at beginning of fiscal year	Depreciation expense	Accumulated depreciation at end of fiscal year
Buildings, structures, and improvements	\$ 2,680,536	138,832	\$ 2,819,368
Land improvements	175,718	11,322	187,040
Machinery and equipment, and furniture and fixtures	214,328	19,024	233,352
Total accumulated depreciation	3,070,582	169,178	3,239,760
Net capital assets, business-type activities	\$ 2,083,857	(160,061)	\$ 1,923,796

Depreciation and amortization expense of business-type activities, amounting to \$169,178 for the fiscal year ended June 30, 2011, was charged to the public housing and welfare function in the accompanying statement of activities.

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9. Long-Term Obligations

The general long-term debt activity for the fiscal year ended June 30, 2011 is as follows:

	Balance at beginning of fiscal year, as restated	Borrowings or additions	Payments and deductions	Balance at end of fiscal year	Balance due within one year
<i>Governmental activities:</i>					
Bonds payable:					
General obligation serial bonds	\$ 10,030,616	\$ 4,850,000	\$ (324,000)	\$ 14,556,616	\$ 370,000
Notes Payable					
Municipal Revenue Collection Center:					
Law No. 146 of October 11, 2001	158,695	-	(34,088)	124,607	34,088
Compensated absences	913,168	1,192,906	(913,168)	1,192,906	533,068
Total for governmental activities	<u>\$ 11,102,479</u>	<u>\$ 6,042,906</u>	<u>\$ (1,271,256)</u>	<u>\$ 15,874,129</u>	<u>\$ 937,156</u>
<i>Business-type activities</i>					
Mortgage notes payable					
Mortgage loan	\$ 943,882	\$ -	\$ (78,674)	\$ 865,208	\$ 81,678
Total for business-type activities	<u>\$ 943,882</u>	<u>\$ -</u>	<u>\$ (78,674)</u>	<u>\$ 865,208</u>	<u>\$ 81,678</u>

Historically, the general fund has been used to liquidate the notes payable to CRIM, the Puerto Rico Health Services Administration and the Puerto Rico Department of Treasury, compensated absences, obligations under capital leases and any other long-term liabilities other than bonds.

a) Debt Limitation

The Municipal Legislature is legally authorized to approve the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth of Puerto Rico also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and the interest on, such bonds and bond anticipation notes (and on all bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or bond anticipation notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable and bond anticipation notes to be repaid with the proceeds of property taxes restricted for debt service.

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b) Bonds Payable

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

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

As more fully described in Note 4, the Municipality levies an annual additional special property tax of 2.00 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at the Government Development Bank for Puerto Rico, fiscal agent, whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual and semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2011:

	Outstanding balance
<u>General Obligation Bonds:</u>	
1991 serial bonds (face amount of \$572,000) due in annual principal installments ranging from \$14,000 to \$41,000; plus interest at 5.00% through July, 1, 2016.	\$ 184,000
2000 serial bonds (face amount of \$870,000) due in annual principal installments ranging from \$40,000 to \$100,000; plus interest at variable rates (4.30% at June 30, 2011) through July, 1, 2011.	100,000
1996 serial bonds (face amount of \$1,040,000) due in annual principal installments ranging from \$15,000 to \$90,000; plus interest at variable rates (6.30% at June 30, 2011) through July, 1, 2020.	665,000
2001 serial bonds (face amount \$575,000) due in annual principal installments ranging from \$10,000 to \$50,000; plus interest at variable rates (4.30% at June 30, 2011) through July, 1, 2026.	475,000

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	<u>Outstanding balance</u>
2002 serial bonds (face amount \$310,000) due in annual principal installments ranging from \$5,000 to \$10,000; plus interest at variable rates (4.50% at June 30, 2011) through July 1, 2027.	260,000
1996 serial bonds (face amount of \$332,000) due in annual principal installments ranging from \$6,000 to \$20,000; plus interest at variable rates (4.50% at June 30, 2011) through July 1, 2028.	263,000
2005 serial bonds (face amount of \$465,000) due in annual principal installments ranging from \$10,000 to \$35,000; plus interest at variable rates (4.50% at June 30, 2011) through July 1, 2029.	405,000
Municipal general obligations bond series 2005-2006 (face amount of \$485,000) due in annual principal installments ranging from \$5,000 to \$35,000; plus interest at variable rates (4.50% at June 30, 2011) through July 1, 2030.	440,000
Municipal general obligations bond series 2007-2008 (face amount of \$800,000) due in annual principal installments ranging from \$25,000 to \$85,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2022.	710,000
Municipal general obligations bond series 2006-2007 (face amount of \$380,000) due in annual principal installments ranging from \$5,000 to \$35,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2032.	365,000
Municipal general obligations bond series 2005-2006 (face amount of \$190,000) due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2021.	155,000
Municipal general obligations note series 2007-2008 (face amount of \$2,965,000) due in annual principal installments ranging from \$60,000 to \$265,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2029.	2,840,000
Ordinance 3 series 2006-2007 from Government Development Bank of Puerto Rico as a loan for construction of a housing development project at Caonillas Ward, Aibonito, P.R.	2,844,616
Municipal general obligations bond series 2010-2011 (face amount of \$1,435,000) due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2021.	1,435,000

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
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	Outstanding balance
Municipal general obligations bond series 2010-2011 (face amount of \$2,710,000) due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2021.	2,710,000
Municipal general obligations bond series 2010-2011 (face amount of \$705,000) due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (1.53% at June 30, 2011) through July 1, 2021.	705,000
Total bonds payables	\$ 14,556,116

Variable interest rates on serial bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the United States of America, (2) in the Eurodollar market, and (3) to corporations having tax exemptions under the Commonwealth's Industrial Incentives Acts and, which qualify for benefits provided by the former Section 936 of the U.S. Internal Revenue Code. Annual debt service requirements of maturity for bonds payable are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2012	370,000	667,398	1,037,398
2013	527,675	729,002	1,256,677
2014	574,675	705,431	1,280,106
2015	592,675	677,611	1,270,286
2016	640,458	628,634	1,269,092
2017-2021	3,308,379	2,831,215	6,139,595
2022-2026	3,530,379	1,943,066	5,473,445
2027-2031	3,864,379	981,111	4,845,490
2032-2036	1,147,995	418,016	1,566,011
	14,556,616	9,581,483	24,138,099

At June 30, 2011, accrued interest payable on bonds amounted to \$291,740.

b) *Law No. 146* – On September 24, 2002, CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Law No. 146 of October 11, 2001, as amended (Law No. 146). The purpose of this financing agreement was to extinguish in advance certain bonds payable issued by Public Finance

MUNICIPALITY OF AIBONITO
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Notes to Financial Statements
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Corporation (PFC), a subsidiary of the Government Development Bank for Puerto Rico, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996, which were acquired by PFC with recourse. The outstanding principal amounted to \$124,607 at June 30, 2011.

c) Mortgage Notes Payable (business-type activities)

The long-term debt of Las Flores Apartments (FHA and HUD Project No. 63-005-660-43-3572) consist of a mortgage note, secured by the Federal Housing Administration and by a first mortgage on rental property. Principal and interests in monthly installments of \$11,654 are payable from the proceeds of the rent collected from the tenants. The Federal government provides housing assistance payments to qualified tenants to subsidize most of the monthly rent. This housing project is administered by a private entity. At June 30, 2011, the outstanding principal balance of the mortgage note amounted to \$865,208.

10. Employees' Retirement Systems

a) Plan Description

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

ERS members, other than those joining it after March 31, 1990, are eligible for the benefits described below:

• **Retirement Annuity**

ERS members are eligible for a retirement annuity upon reaching the following age:

Policemen and firemen:	Other employees:
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

ERS members are eligible for monthly benefit payments determined by the application of the stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a member is eligible, is limited to a minimum of \$300 per month and a maximum of 75 percent of the average compensation.

MUNICIPALITY OF AIBONITO
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June 30, 2011

- ***Merit Annuity***

ERS members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65 percent and a maximum of 75 percent of the average compensation.

- ***Deferred Retirement Annuity***

A participating employee who ceases to be an employee of the Municipality after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions are left in ERS until reaching 58 years of age.

- ***Coordinated Plan***

On the coordinated plan, by the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- (a) \$165 per month, if retired with 55 years of age and 30 years of credited service.
- (b) \$110 per month, if retired with less than 55 years of age and 30 years of credited service.
- (c) All other between \$82 and \$100 per month.
- (d) Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over \$165 per month.

- ***Non-Coordinated Plan***

On the non-coordinated plan the participating employee and does not have any change on the pension benefits upon receiving social security benefits.

- ***Reversionary Annuity***

An ERS member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than \$240 per year or greater than the annuity payments being received by the retiree.

- ***Occupational Disability Annuity***

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50 percent of the compensation received at the time of the disability.

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
Notes to Financial Statements
June 30, 2011

- ***Non-occupational Disability Annuity***

A participating employee, totally and permanently disabled for causes not related to his/her occupation and with no less than 10 years of credited service, is eligible for an annuity of 1.50 percent of the average compensation of the first 20 years of credited services, increased by 2 percent for every additional year of credited service in excess of 20 years.

- ***Death Benefits***

Occupational:

- (a) **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.
- (b) **Children** - \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

Non-occupational:

Beneficiary – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

Post-retirement:

Beneficiary with surviving spouse age 60 or over and a child, 18 or under, up to 30 percent (60 percent, if not covered under Title II of the Social Security Act) (increased to 50 percent effective January 1, 2005) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

- ***Refunds***

A participating employee who ceases his/her employment with the Municipality without the right to a retirement annuity has the right to a refund of the contributions to ERS plus any interest earned thereon.

- ***Cost of Living Adjustment for Pension Benefits***

Public Act No. 10 of May 21, 1992 (Act No. 10) provided for increases of 3 percent every three or more years of retirement. Act No. 10 requires further legislation to grant this increase every three years subject to the presentation of actuarial studies regarding its costs and the source of financing. To protect the financial health of ERS, the increase granted during 2001 and the one granted on January 1, 2005 are being financed by the Municipality and the other participating employers.

To avoid any economic impact on ERS, the employers are responsible for contributing to ERS the amounts to cover the benefit payments and the employer and

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
Notes to Financial Statements
June 30, 2011

employee contributions with respect to the participants covered until the participants reach the normal retirement age.

- *Amendment to Act No. 447 effective January 1, 2000 to create a Defined Contribution Plan*

On September 24, 1999, Public Act No. 305, an amendment to Act No. 447, was enacted to establish a defined contribution plan, known as System 2000, to cover employees joining ERS on or after January 1, 2000.

Employees that participated in the original plan as of December 31, 1999, had the opportunity to elect to either stay in the defined benefit plan or transfer to System 2000. Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

Historically, the state government of the Commonwealth of Puerto Rico has reported ERS and System 2000 in its basic financial statements as pension trust funds. Accordingly, the Commonwealth is currently assuming any actuarial deficiency that may exist or arise related to the Municipality's participating employees because ERS does not allocate to the Municipality any actuarial deficiencies pertaining to participating municipal employees. The Municipality is only required by law to make statutory contributions at the rates detailed below.

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
Notes to Financial Statements
June 30, 2011

• ***Recent Amendments to Act No. 447***

The Senate and the House of Representatives of the Commonwealth of Puerto Rico have the authority for establishing or amending the contribution requirements of System 2000 by approving the necessary amendments or laws, subject to the final approval of the Governor of the Commonwealth of Puerto Rico.

In June and July 2003, the Governor of the Commonwealth signed three Public Acts that provided the following certain benefits to retirees:

- (a) Increase in minimum monthly pension payments to \$300, effective January 1, 2005.
- (b) Triennial 3 percent increase in all pensions, effective January 1, 2005.
- (c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2005.

All the benefits granted will be funded through budgetary assignments in the Municipality's general fund with respect to its retired employees.

The Board of Trustees of ERS approved, effective November 17, 2003, an increase in the amount granted on personal loans to participating employees from \$3,000 to \$5,000.

b) *Funding Policy*

The contribution requirement to ERS is established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	
Coordination plan:	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.
Supplementation plan:	8.28 percent of gross salary. This is the only choice available to policemen, firemen and mayors

The contribution requirement to System 2000 is also established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	
	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.

MUNICIPALITY OF AIBONITO
COMMONWEALTH OF PUERTO RICO
Notes to Financial Statements
June 30, 2011

11. Commitments and Contingencies

The Municipality has reported, outstanding encumbrances amounting to \$661,118 in the general fund at June 30, 2011. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

12. Fund Balances

As of June 30 2011, fund balance is comprised of the following:

<i>Fund balances:</i>	<u>General fund</u>	<u>Debt service fund</u>	<u>Legislative joint resolution fund</u>	<u>Capital projects fund</u>	<u>Special communities trust funds</u>	<u>Other governmental funds</u>	<u>Total</u>
Restricted:							
Debt service	\$ -	1,799,180	-	-	-	-	\$ 1,799,180
Capital projects	-	-	3,072,259	8,825,463	-	-	11,897,722
Federal funded programs	-	-	-	-	774	1,924,278	1,925,052
Assigned for:							-
General government	661,118	-	-	-	-	-	661,118
Unassigned	86,966	-	-	-	-	-	86,966
Total fund balances	<u>\$ 748,084</u>	<u>1,799,180</u>	<u>3,072,259</u>	<u>8,825,463</u>	<u>774</u>	<u>1,924,278</u>	<u>\$ 16,370,038</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Revenues and Expenditures -
Budget and Actual - Budgetary Basis - General Fund
Fiscal Year Ended June 30, 2011

	<u>Budgeted amounts</u>		Actual amounts (budgetary basis)	Variance with final budget- over (under)
	Original	Final		
Revenues				
Property taxes	2,209,825	2,329,576	2,209,825	(119,751)
Municipal license taxes	1,600,000	1,761,323	1,789,771	28,448
Sales and taxes	285,000	538,605	604,054	65,449
Construction excise taxes	190,000	179,411	323,249	143,838
Charges for services	38,000	59,503	74,495	14,992
Intergovernmental grants and contributions	4,129,523	3,896,944	3,946,199	49,255
Interest	56,000	117,867	136,638	18,771
Miscellaneous	1,086,118	1,267,302	1,154,501	(112,801)
Total revenues	<u>9,594,466</u>	<u>10,150,531</u>	<u>10,238,732</u>	<u>88,201</u>
Expenditures				
Current:				
General government	4,451,807	4,448,393	3,589,145	(859,248)
Public safety	124,108	109,039	85,721	(23,318)
Urban and economic development	3,784,286	4,277,879	3,550,706	(727,173)
Health and sanitation	-	-	359,359	359,359
Culture, recreation and education	1,017,993	1,096,485	1,042,383	(54,102)
Public housing and welfare	216,272	218,735	208,016	(10,719)
Capital outlay	-	-	191,185	191,185
Total expenditures	<u>9,594,466</u>	<u>10,150,531</u>	<u>9,026,515</u>	<u>(1,124,016)</u>
Revenues over (under) expenditures	-	-	<u>1,212,217</u>	<u>1,212,217</u>
Other financing sources (uses):				
Transfers from other funds	-	-	214,961	214,961
Transfers to other funds	-	-	-	-
Total other financing sources, net	-	-	<u>214,961</u>	<u>214,961</u>
Revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>1,427,178</u>	<u>\$ 1,427,178</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Expenditures of Federal Awards
June 30, 2011

	<u>Federal CFDA Number</u>	<u>Pass-through Grantor's Number</u>	<u>Expenditures</u>
U.S. Department of Housing and Urban Development			
Section 8 Housing Assistance Payment	14.182	RQ46R000013	\$545,336
Section 8 Housing Choice Voucher	14.871	RQ-059	\$223,533
Pass-through of the State-Office of the Municipal Affairs Commissioners – Community Development Block Grant/State – Administered Small Cities	14.228	2011-004103	728,344
Homelessness Prevention and Rapid Rehousing Program (ARRA Funded)	14.257	FR-5307-N-01	<u>188,946</u>
Total U.S. Department of Housing and Urban Development			<u>1,686,159</u>
Total Federal Financial Assistance			<u>\$1,686,159</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Schedule of Expenditures of Federal Awards
June 30, 2011

1. General

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Aibonito of the Commonwealth of Puerto Rico and is presented on the accrual basis of accounting. The Municipality of Aibonito reporting entity is defined in Note 1 to the Municipality's basic financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in our used in the preparation of the basic financial statements.

2. Relationship to the Basic Financial Statements

Revenues and expenditures of the federal awards are included in the Municipality's basic financial statements within the Capital Projects Fund, the Proprietary Fund and the Nonmajor Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Expenditures in the basic financial statements:

Capital Projects Fund	\$ 1,092,641
Other governmental funds	605,388
Proprietary Fund	<u>550,362</u>
	2,248,391
Less: Non-federal expenditures	<u>(562,232)</u>
	Total expenditures in the Schedule of Federal Awards
	<u>\$1,686,159</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO

Report on Compliance and on Internal Control over Financial Reporting Based on an
Audit of Financial Statements performed in accordance with Government Auditing Standards
June 30, 2011

To the Honorable Mayor
and the Municipality of Aibonito
Aibonito, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated November 28, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Municipality's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality of Aibonito of the Commonwealth of Puerto Rico internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses as items 11-01 to 11-03.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Aibonito of the Commonwealth of Puerto Rico financial statements are free of material misstatement, we performed tests of its

compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 11-04 thru 11-08.

We noted certain matters that we reported to management of the Municipality of Aibonito of the Commonwealth of Puerto Rico, in a separate letter dated November 28, 2011.

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

This report is intended solely for the information and use of the Municipality's management, municipal legislature, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Toa Alta, Puerto Rico
November 28, 2011

Stamp No. 2596734
was affixed to the
original report.

A large, stylized handwritten signature in black ink, followed by the initials "CPA-PSC" written in a similar style.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO**

Report on compliance with requirements that could have a direct and material effect on each major program and on Internal Control over compliance in accordance with OMB Circular A-133
June 30, 2011

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

Compliance

We have audited the Municipality of Aibonito of the Commonwealth of Puerto Rico (the Municipality) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have direct and material effect on each of the Municipality of Aibonito of the Commonwealth of Puerto Rico major federal programs for the year ended June 30, 2011. Municipality's major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality's management. Our responsibility is to express an opinion on Municipality's compliance based on our audit.

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

As described in items 11-05, 11-06, and 11-07 in the accompanying Schedule of Findings and Questioned Costs, the Municipality of Aibonito of the Commonwealth of Puerto Rico, did not comply with requirements regarding Equipment and Real Property Management, cash management, and Davis-Bacon Act, that are applicable to its Community Development Block Grant – State Program. Compliance with such requirements is necessary, in our opinion, for the Municipality, to comply with the requirements applicable to that program.

As described in item 11-08 in the accompanying Schedule of Findings and Questioned Costs, the Municipality of Aibonito of the Commonwealth of Puerto Rico, did not comply with requirements regarding the financial reporting, that is applicable to its Section 8 Housing Assistance Payment Program. Compliance with such requirement is necessary, in our opinion, for the Municipality, to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraphs, the Municipality of Aibonito of the Commonwealth of Puerto Rico, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

Internal Control Over Compliance

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

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 significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 11-01, 11-02 and 11-03 to be material weaknesses.

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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 11-04 and to be a significant deficiency.

Municipality's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Municipality's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Municipality's management, Municipal legislature, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Toa Alta, Puerto Rico
November 28, 2011

Stamp No. 2596735
was affixed to the
original report.



CPA-PSC

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2011

Section I - Summary of Auditors' Results

Financial Statements

Type of auditor's report issued: Qualified

Internal control over financial reporting:

Material weakness (es) identified? yes no

Significant deficiency (ies) identified
not considered to be material weakness? yes none reported

Noncompliance material to financial statements yes no
noted?

Federal Awards

Internal Control over major programs:

Material weakness (es) identified? yes no

Significant deficiency (ies) identified
not considered to be material weaknesses? yes none reported

Type of auditor's report issued on compliance
For major programs: Qualified

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:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
14.182	Section 8 Housing Assistance Payments
14.228	Community Development Block Grant/State – Administered Small Cities Program

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

Auditee qualified as low-risk auditee? yes no

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Section II - Financial Statement Findings

The current year findings and questioned costs were discussed with the Municipality's management which generally concurred with our comments and recommendations. The Municipality of Aibonito will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

11-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS

The Uniform Accounting System (UAS) and the accounting records currently used by the Municipality do not have the necessary capabilities, procedures, internal controls and records to ensure accurate financial reporting and to prepare the Municipality's basic financial statements and federal programs' reports in conformity with Accounting Principles Generally Accepted in the United States of America for State and Local Governments (GAAP). The UAS is a system promulgated by the Office of the Commissioner of Municipal Affairs of Puerto Rico (OCAM, by its Spanish acronyms), a governmental entity created by law to provide technical assistance to the municipalities of Puerto Rico in several administrative and fiscal matters.

The Municipality's UAS mostly provides for the recording of revenue collections, disbursements and other limited transactions. In addition, the accounting records are not fully integrated, and a double entry system is not generally followed. Accounting records are maintained on the cash basis and budgetary accounting bases (two accounting bases that differ significantly from GAAP) and do not comply with Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended.

The following specific additional conditions were noted in relation to the UAS of the Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- The UAS does not have the capabilities of: (1) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (2) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (3) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, etc.
- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

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- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end.
- The management of the federal programs administered by the Municipality maintains separate accounting records for each federal program, which are not reconciled with the UAS (the official accounting system of the Municipality).
- No adequate and complete accounting records are kept for inter-fund balances and transactions.
- The audit adjustments resulting from Single Audits are not completely posted in the UAS.

The basic financial statements of the Municipality must be prepared using the financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators and independent third parties. In addition, the Department of Finance does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

The Department of Finance does not maintain accounting records supporting the following procedures performed as part of the preparation of the basic financial statements of the Municipality:

- The conversion of accounting records from the cash basis of accounting to the modified accrual basis of accounting used by governmental funds;
- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and
- Working papers and analyses of significant balances reported in the basic financial statements, such as capital assets, accounts receivable (municipal licenses, grants and contributions, etc.), deferred revenues, accounts payable, and long-term obligations (for which the general practice is to rely upon the notifications received from the Government Development Bank for Puerto Rico, the Puerto Rico Treasury Department, the Federal Government and the Municipal Revenue Collection Center for the balance of its outstanding debt and the withholding for its debt service).

CRITERIA:

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete

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information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2011 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

CAUSE AND EFFECT:

These conditions occurred because the accounting system currently used by the Municipality has not been updated in over 15 years and, accordingly, the Municipality has not implemented an accounting system in compliance with the current accounting model established by GASB Statement No. 34, as amended. The continued failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process. In addition, financial reports prepared may have errors or omissions that will affect future financial decisions. Another effect is the use of inaccurate financial information as a base for the preparation of annual budgets, which, therefore, may result in budgetary compliance problems.

RECOMMENDATION:

We recommend the Municipality to explore different alternatives for the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations. This process should include only accounting systems that will enable the Municipality to prepare its basic financial statements in a timely manner and in conformity with GAAP. The systems to be evaluated must provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements, including:

- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for federal funds;
- The preparation of periodic financial reports to be submitted to the Director of Finance, the Mayor, the Municipal Legislature and the federal grantors; and
- Adequate training to all accounting personnel to improve the understanding of the system and to promote operational efficiency

The Department of Finance must establish and document new accounting policies and procedures addressed to correct the non-compliance situations referred to above. Accounting policies and procedures shall be promulgated by an appropriate level of management to emphasize their importance and authority.

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The documentation of such accounting policies and procedures shall be updated periodically according to a predetermined schedule.

11-02 DEFICIENCIES IN ACCOUNTING RECORDS OF CAPITAL ASSETS

The Municipality does not have an effective system to account for the accurate recording of fixed assets. There are no internal controls to ensure that all capitalizable expenditures and property dispositions are recorded in the capital assets subsidiary ledger. A significant portion of the real property, personal property and infrastructure acquired or constructed with federal and local funds is not currently recorded in the capital assets subsidiary ledger. Accordingly, the Municipality has not maintained complete and adequate records over capital assets.

The Municipality has not performed periodical physical inventories of its capital assets (real property, and infrastructure). As part of our internal control and substantive tests, we noted that the Municipality has not organized and performed a physical inventory during the fiscal year ended June 30, 2011 for the abovementioned assets. Accordingly, the capital assets recorded in the accompanying statement of net assets do not include several items of the real property and the infrastructure assets, which should be reported as part of the capital assets of the Municipality according to Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended, *Basic Financial Statements – and Management’s Discussion and Analysis for State and Local Governments*.

The following additional conditions were noted in relation to capital assets:

- The Municipality’s capital asset subsidiary ledger is not reviewed or updated on a regular basis for the purposes of identifying and removing those items that have been impaired, taken out of service or provide no future benefit. As a result, the capital assets subsidiary ledger does not accurately provide sufficient and competent evidence of the existence, ownership and valuation of the capital assets owned by the Municipality.
- The Municipality does not have formal accounting and control procedures and policies to ensure compliance with the capital assets requirements established by GASB No. 34 and Statement No. 42 of the Governmental Accounting Standards Board, *Accounting and Reporting for Impairments of Capital Assets and Insurance Recoveries* (GASB No. 42).
- The subsidiary ledger of capital assets is not periodically reconciled with the property subsidiary ledgers maintained by the Municipality’s several individual federal financially assisted programs.

CRITERIA:

Article 9.002 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that all municipalities must prepare and maintain an updated subsidiary ledger (record) of all real properties.

In addition, Chapter VII, Section 23, of the *Regulation for Municipal Administration*, requires that each Municipality must maintain an adequate control of capital assets through annual physical inventories. In addition, any differences between physical inventory amounts and subsidiary records must be investigated and adjusted. Considering that according to accounting records of the Municipality, the capital assets

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represent the most significant assets of the Municipality, there is a significant risk of unauthorized use or disposition of capital assets because there are no adequate internal controls in place to ensure accountability of capital assets by department or federal program.

Chapter VII, Sections 3, 4, 14, 15 and 21 of the *Regulation for Municipal Administration* establish the following guidelines regarding property management:

- Section 3 establishes that the Finance Director is responsible for the accountability of the capital assets acquired by the Municipality through purchases or donations.
- Section 4 establishes that the Municipal Property Administrator shall be responsible to the Mayor and the Finance Director for the direct administration, use and maintenance of the entire real and personal property owned by the Municipality.
- Section 14(1) establishes that all municipal property shall be numbered and identified as to ownership by the Municipal Property Administrator.
- Section 15(1) establishes that the Municipal Property Administrator is responsible for accurately maintaining the central property records.
- Section 21(c) establishes that management shall write-off from the property records all property and equipment sold or disposed of when certified by the Internal Auditor of the Municipality upon determination that such disposal is adequate.

CAUSE AND EFFECT:

These instances of non-compliance occurred because the Property Division of the Municipality has not enforced the requirement to perform a capital assets inventory and to ensure the proper accountability of capital assets during the fiscal year ended June 30, 2011. Accordingly, the Municipality's internal controls in place over capital assets are not designed to effectively account for capital assets, since it do not allow for the reconciliation of detailed property records with the general ledger. These inadequate property internal controls may expose the Municipality to questioned or disallowed costs by the federal government for lost or stolen property. This condition represents a material weakness in the Municipality's internal controls over financial reporting.

Furthermore, this situation represents a significant risk of loss of capital assets because there is a lack of accountability for acquired capital assets. Any federally funded capital assets lost would need to be repaid to the federal government with municipal funds.

RECOMMENDATION:

A physical inventory of the Municipality's capital assets should be taken as soon as possible and subsequently on annual basis. Physical inventory amounts should be reconciled with the capital assets recorded in the subsidiary ledgers. Furthermore, the Mayor may issue an executive order to require compliance with this requirement. For these purposes, the Property Division of the Municipality must require from each Municipal Department that acquires or manage capital assets to submit a report including a full description of the asset, location, use, source of funds used to acquire the asset,

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responsible personnel, cost and any other pertinent data required by state and local regulations. This information should be reconciled with the monthly disbursements (capital outlays) made against the budgetary accounts used for property acquisitions. Sales or other dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director, and should be carried out by persons other than the users and through public announcements or bids.

We also recommend that the subsidiary ledger of capital assets be updated on a monthly basis for the write-off of non-operational, fully depreciated, or impaired items. Having such a procedure in place will ensure that the Municipality has an accurate record of its capital assets and will ensure that gains and losses on disposals are recorded in the proper accounting period.

We also recommend that the subsidiary ledger shall be periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal programs.

To provide greater control over the recording of capital asset additions and retirements, we also recommend the Municipality to maximize the use of the Assetmax software package to automate the recording of capital assets along with automatically computing depreciation expense for financial reporting purposes. The use of such software package would improve the overall efficiency within the accounting function and allow for departmental reporting of depreciation expense, including federal programs.

11-03 LACK OF MONITORING AND FRAUD PREVENTION ACTIVITIES

As part of our evaluation of internal controls of the Municipality we noted that the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. In addition, does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

CRITERIA:

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the Municipality shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), and (3) all accounts, records, books, contracts, budgets and any other financial activities.

CAUSE AND EFFECT:

These conditions arose by the lack of effective controls and procedures for the evaluation of significant risk factors in all municipal areas, the lack of proper planning of continued monitoring activities, and the lack of proper allocation of human resources and time schedules to perform the activities required by law. These conditions, if not corrected, may increase the risk of instances of material unforeseen errors and irregularities that may not be detected in a timely manner by the current internal controls of the Municipality.

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RECOMMENDATION:

We also recommend the Municipality to prepare a manual of policies and procedures specifically designed to prevent and detect fraud. The Municipality should also keep formal documentation of all fraud prevention and monitoring activities performed by management, including the identification and evaluation of all fraud risk factors. Fraud risk assessments should be reviewed periodically to consider changes in the operating policies of the Municipality and the control environment.

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Section III - Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
All Federal Programs	11-04 FINANCIAL REPORTING	

Statement of Condition:

Our review of the Single Audit Reporting Package and Data Collection Form for each of the two prior years submitted to Federal Audit Clearinghouse (FAC), disclosed that one year was submitted after the required submission date, as detailed below.

<u>Year Ended</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>Past Due Days</u>
June 30, 2010	March 31, 2011	June 20, 2011	81 days

Criteria:

According to OMB Circular A-133 section 320, Report Submission, the audit shall be completed and the data collection form described and reporting package shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. Unless restricted by law or regulation, the auditee shall make copies available for public inspection.

Cause and Effect:

This condition occurred because the Municipality has not adopted adequate internal controls and procedures designed to ensure the timely submission of programs reports and the lack of adequate training and supervision of the municipal employees in charge of the preparation of the aforementioned reports.

This condition, if not corrected, may increase the risk of avoidable instances of material non-compliances with the laws and regulations applicable to the Program.

Recommendation:

The Municipality should improve existing procedures to ensure the timely submission of the Single Audit Reporting Package and Data Collection Form, in order

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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP CFDA No. 14.228	<p>to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.</p> <p>11-05 EQUIPMENT AND REAL PROPERTY MANAGEMENT</p> <p>Statement of Condition:</p> <p>The Municipality has not complied with the property management requirements. There were no physical inventories performed during the fiscal year ended June 30, 2011.</p> <p>The Community Development Block Grant Program has a subsidiary ledger of equipment acquired with federal funds, however, such subsidiary ledger does not comply with federal requirements because it does not: (1) have information needed to calculate the federal share of the cost of the equipment, (2) identify the grant under which the program acquired the equipment, (3) have information about the location, use and condition of the equipment and the date the information was obtained, and (4) have all pertinent information on the ultimate transfer, replacement, or disposal of the equipment.</p> <p>Furthermore, there is no evidence that the total amount of capital expenditures and the composition of capital assets incurred of the Community Development Block Grant have been reconciled with the general ledger or other control account to enhance the controls to prevent unauthorized disposition of assets.</p> <p>Criteria:</p> <p>29 CFR 97.32 (d) (2) established that the Municipality should take the physical inventory and reconcile the results with the property records. In addition, Section (d) (3) establishes that a control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property.</p>	NONE

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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Federal regulations also require that, every two years, at a minimum, a physical inventory shall be conducted and the results shall be reconciled with property records to verify the existence, current utilization, and continued need for the equipment. Any discrepancies between quantities determined by the physical inspection with those shown in the accounting records shall be investigated to determine the causes of the differences. Property records shall be accurate. Property records shall include the following for each item:

- A description of the equipment including manufacturer's serial numbers.
- Identification number, as the manufacturer's serial numbers.
- Identification of the grant under which the recipient acquired the equipment.
- The information needed to calculate the federal share of the cost of the equipment.
- Acquisition date and unit acquisition cost.
- Location, use and condition of the equipment and the date the information was obtained.
- All pertinent information on the ultimate transfer, replacement or disposal of the equipment.

Cause and Effect:

These instances of non-compliance occurred because the Property Division of the Municipality has not enforced the requirement to perform a capital assets inventory and to ensure the proper accountability of capital assets during the fiscal year ended June 30, 2011. Accordingly, the Municipality's internal controls in place over capital assets are not designed to effectively account for capital assets, since it do not allow for the reconciliation of detailed property records with the general ledger. These inadequate property internal controls may expose the Municipality to questioned or disallowed costs by the federal government for lost or stolen property. This condition represents a material weakness in the Municipality's internal controls over financial reporting.

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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Furthermore, this situation represents a significant risk of loss of capital assets because there is a lack of accountability for acquired capital assets. Any federally funded capital assets lost would need to be repaid to the federal government with municipal funds.

Recommendation:

A physical inventory of the Federal Programs capital assets should be taken as soon as possible. Physical inventory amounts should be reconciled with the property recorded on the subsidiary ledgers. This information should be reconciled with the monthly disbursements made against the budgetary accounts used for property acquisitions. Dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance.

SBGP
CFDA No. 14.228

11-06 FEDERAL CASH MANAGEMENT SYSTEM

Statement of Condition:

NONE

The Municipality has not established effective cash management procedures. During our review of the drawdowns performed during the year, we noted the following deficiency:

a. The Municipality performed 27 drawdown during the 2010-2011 fiscal year amounting to \$607,172. For 7 drawdown amounting to \$279,802 or (26%) the disbursements related to the funds requested has a delay of 3 days or more between the funds receiving date and the disbursing date.

Criteria:

Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.

Cause and Effect:

This condition arose because the Municipality has not implemented specific internal controls and procedures designed to minimize the time elapsed between the time

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Findings/Noncompliance Recommendations

Questioned Cost

when drawdowns are made and the subsequent time when disbursement of federal funds are carried out. This condition increases the risks of avoidable interest income and instances of idle cash balances in the program's bank accounts.

Recommendation:

In accordance with Federal regulations, the Municipality should estimate drawdown's of Federal funds as closely as possible to the actual disbursements. Also, the Municipality should established procedures to minimize the time elapsing between drawdowns and disbursements.

SBGP
CFDA 14.228

11-07 DAVIS-BACON ACT

Statement of Condition:

As part of our audit tests we selected two (100%) construction projects out of 2 projects executed during the fiscal year. The construction projects were the following:

- Diseño y Construcción del Parque de Pelota, Cancha de Baloncesto y Centro de Usos Múltiples de la Comunidad Los Cuadritos, Barrio Asomante
- Repavimentación de varios caminos municipales Barrio Caonillas y Extensión San Luis

The following exceptions were noted during our examination of the projects files:

NONE

- (a) In one (1) 50% project file, one employee was paid below the minimum salary rate.
- (b) In one (1) 50% project file, the payrolls submitted by contractor are not certified as required by the federal regulations.
- (c) In one (1) 50% project file, the payrolls submitted by the contractor do not include the required employee information (address, social security number and position).

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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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- (d) In two (2) 100% of project files, there were no evidence of the required preconstruction conference.
- (e) In one (1) 50% of project file, there were no evidence of interviews performed to project employees.

Criteria:

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR sections 5.5 and 5.6).

Cause and Effect:

This condition arose because the Municipality has not implemented specific internal controls and procedures designed to carry out effective monitoring activities over contractors engaged in projects financed with federal funds, including, but not limited to, the enforcement of compliance with contractual clauses related to Davis-Bacon Act and the training of municipal employees about this law.

This condition, if not corrected, may increase the risk of avoidable instances of material non-compliances with the laws and regulations applicable to the Program.

Recommendation:

The Municipality should establish procedures to ascertain that all documents submitted by the contractor are reviewed and approved on a timely basis to ensure compliance with labor standards.

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<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
Section 8 HAP CFDA No. 14.182 RQ-46R000013	11-08 FINANCIAL REPORTING	

Statement of Condition:

Our review of the monthly Housing Owner's Application for Housing Assistant Payments (Form HUD 52670) submitted to Housing and Urban Development offices, disclosed that they were submitted after the required submission date, as detailed below.

NONE

<u>Month</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>Past Due Days</u>
July 2010	June 10, 2010	June 16, 2010	6 days
November 2010	October 11, 2010	October 12, 2010	1 day
February 2011	January 10, 2011	January 11, 2011	1 day
March 2011	February 10, 2011	February 11, 2011	1 day

Criteria:

According to HUD Handbook 4350.3 - Housing Owner's Application for Housing Assistant Payments (Form HUD 52670). The deadline for transmission of vouchers (form HUD-52670) and all related TRACS files supporting the voucher is the 10th calendar day of the month directly preceding the voucher payment month. For example, the February voucher TRACS transmission would be due on January 10.

Cause and Effect:

This condition occurred because the Project Administrator has not adopted adequate internal controls and procedures designed to ensure the timely submission of program reports and the lack of adequate training and supervision of the municipal employees in charge of the preparation of the aforementioned reports. This condition, if not corrected, may increase the risk of avoidable instances of material non-compliances with the laws and regulations applicable to the Program.

Recommendation:

The Project Administrators should improve existing procedures to ensure the timely submission of the Housing Owner's Application for Housing Assistant

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Payments (Form HUD 52670), in order to comply with Federal regulation. Also, the Project Administrator should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Project Administrators in complying with the federal regulation.

Total Questioned Costs

NONE

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 Summary schedule of prior years audit findings
 Fiscal Year 2009-2010
 June 30, 2011

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2010. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2010-2011).
- NR - Not resolved yet. Finding repeated in fiscal year 2010-2011.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
10-01	Deficiencies in the uniform accounting system and other accounting records	NR
10-02	Depositing of cash receipts in bank accounts	FR
10-03	Inactive and unnecessary funds and inactive bank accounts	FR
10-04	Deficiencies in accounting records of capital assets	NR
10-05	Lack of monitoring and fraud prevention activities	NR

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 Fiscal Year 2009-2010
 June 30, 2011

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2010. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2010-2011).
- NR - Not resolved yet. Finding repeated in fiscal year 2010-2011.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
10-06	Internal Controls – Information and communication	FR
10-07	Procurement, Suspension and Debarment	FR
10-08	Equipment and real property management	NR
10-09	Federal Cash Management System	NR
10-10	Federal Cash Management System	FR
10-11	Davis-Bacon Act	NR
10-12	Earmarking Requirement	FR
10-13	Inadequate Documentation of Participant Files	FR
10-14	Financial Reporting	NR

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 Summary schedule of prior years audit findings
 Fiscal Year 2008-2009
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The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2009. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2010-2011).
- NR - Not resolved yet. Finding repeated in fiscal year 2010-2011.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
2009-II-01	Material weakness in prepared financial statements	FR
2009-II-02	Material weakness in prepared financial statements	NR
2009-II-03	Material noncompliance and material weakness in prepared Schedule of Expenditures of Federal Awards	FR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Summary schedule of prior years audit findings
Fiscal Year 2008-2009
June 30, 2011

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2009. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2010-2011).
- NR - Not resolved yet. Finding repeated in fiscal year 2010-2011.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
2009-III-01	Allowable Cost/Cost Principle	PR
2009-III-02	Cash Management	PR
2009-III-03	Davis Bacon	NR
2009-III-04	Procurement, Suspension and Debarment	NR
2009-III-05	Reporting	FR
2009-III-06	Reporting	FR

