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López-Vega, CPA, PSC

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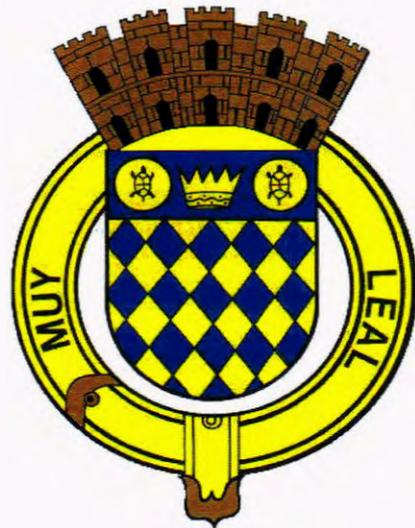
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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARECIBO

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

Year Ended June 30, 2011



Municipality of Arecibo, P.O. Box 1086, Arecibo, Puerto Rico 00613
Hon. Lemuel Soto Santiago
Mayor

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

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

YEAR ENDED JUNE 30, 2011

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

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

YEAR ENDED JUNE 30, 2011

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Member of:

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

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arecibo, Puerto Rico**, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements as listed in the 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.

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

The financial statements referred to above include only the primary government of the **Municipality of Arecibo**. The financial statements do not include financial data for the legally separated discrete component unit, "Corporación Desarrollo Cultural Teatro Oliver C.E.", which accounting principles generally accepted in the United States of America require to be reported with the financial data of the primary government. As result, the primary government financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2011 and the changes in its financial position and its cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the primary government of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2011, and the respective changes in financial position, thereof for the year then ended 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 March 21, 2012, on our consideration of the **Municipality's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards 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 **3** through **13** and **57** 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 the 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 of Arecibo's** 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, Local Governments, and Non-Profit Organizations, and is also not a required part of the financial statements.



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INDEPENDENT AUDITORS' REPORT (CONTINUED)

The schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain 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.

Lopez Vega CPA, PSC
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 21, 2012

Stamp No. 2575545 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2011

This discussion and analysis of the **Municipality of Arecibo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2011. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2010. This MD&A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

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

FINANCIAL HIGHLIGHTS

The following comments about the financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2011 deserve special mention:

1. The Municipality net assets decreased by \$3,246,380.
2. In the fund financial statements, the governmental activities revenues increased \$3,864,796 (or 6%) while governmental activities expenditures decreased \$4,738,705 (or 6%) in comparison with prior year.
3. The general fund (the primary operating fund) reflected, on a current financial resource basis, an increase of \$298,862.
4. On a budgetary basis, actual expenditures exceeded actual revenues by \$2,044,202, caused mainly due to unfavorable variances in revenues accounts.
5. As of the close of the current fiscal year, the Municipality's Governmental Funds reported combined ending fund balances of \$24,438,615.
6. As the end of the current fiscal year the Municipality's General Fund deficit amounted to \$10,357,444, compared to a deficit of \$10,656,306 in the prior fiscal year, as restated.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2011

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2011. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

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

FINANCIAL STATEMENTS COMPONENTS

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

The Statement of Net Assets reflects information of the Municipality as a whole of a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of The Statements of Activities of the Municipality at June 30, 2011, shows total expenses incurred to afford the cost of all functions and programs amounted to \$70,749,196. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that \$25,833,447 was derived from the following sources: \$1,225,748 charges for services; \$21,825,726 from operating grants and contributions; and \$2,781,973 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$41,669,369.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2011

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

There was a deficit of revenues over expenses in the amount of \$3,246,380 which decreased the figure of net assets attained at the end of the fiscal year.

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As of July 1, 2002, the Municipality commenced the prospective reporting of infrastructure assets. The Municipality expects to retroactively report historical costs of infrastructure assets during the fiscal year beginning on July 1, 2006.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

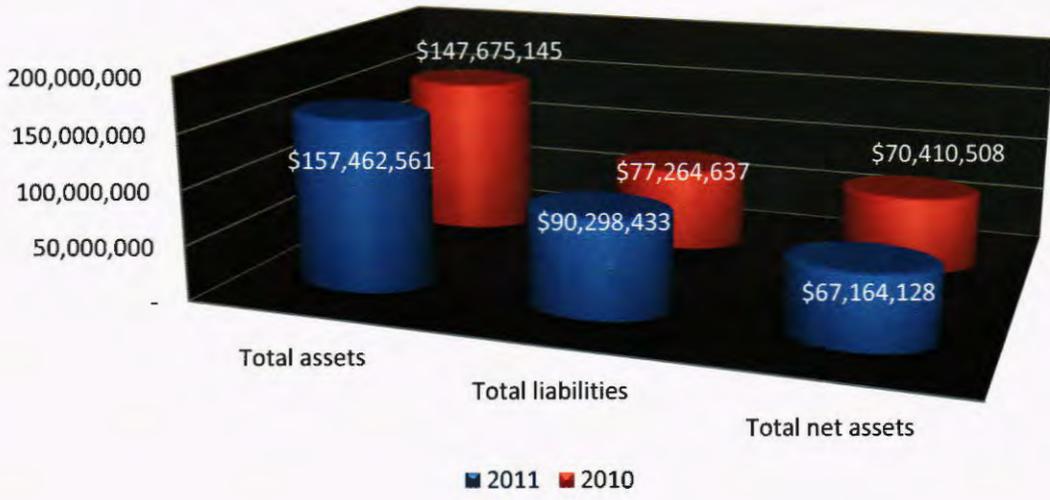
YEAR ENDED JUNE 30, 2011

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the **Municipality of Arecibo**, primary government total assets exceeded total liabilities by \$67,164,128 at the end of 2011, compared to \$70,410,508 at the end of the previous year, as restated, and showed in the following condensed Statement of Net Assets of the Primary Government.

Condensed Statement of Net Assets	2011	2010	Change	%
Current and other assets	\$ 35,601,416	\$ 28,364,287	\$ 7,237,734	26%
Capital assets	121,861,145	119,310,858	2,550,287	2%
Total assets	157,462,561	147,675,145	9,788,021	7%
Current and other liabilities	11,439,699	10,403,109	1,036,590	10%
Long-term liabilities	78,858,734	66,861,528	11,997,206	18%
Total liabilities	90,298,433	77,264,637	13,033,796	17%
Invested in capital assets, net of related debt	89,856,145	90,230,859	(374,714)	(.4%)
Restricted	34,680,883	28,128,928	6,551,955	23%
Unrestricted deficit	(57,372,900)	(47,949,279)	(9,423,621)	(20%)
Total net assets	\$ 67,164,128	\$ 70,410,508	(3,246,380)	(5%)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2011

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2011, the net effect of revenues derived from several programs plus current operating revenues compared to the total expenses, amounted to a decrease of \$3,246,380 in the Municipality's net assets. Approximately 46 percent of the Municipality's total revenue came from taxes, while 50 percent resulted from grants and contributions, including federal aid. Charges for services, interest and investment earnings and miscellaneous categories, provided 4 percent. The Municipality's expenses cover a range of services. The largest expenses were for general government, public safety, and public works. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

Condensed Statement of Activities	2011	2010	Change	%
Program revenues:				
Charges for services	\$ 1,225,748	\$ 1,106,526	119,222	11%
Operating grants and contributions	21,825,726	19,906,969	1,918,757	7%
Capital grants and contributions	2,781,973	3,495,507	(713,534)	(20%)
General revenues:				
Property taxes	18,266,463	15,686,019	2,580,444	16%
Municipal license tax	7,274,927	9,825,291	(2,550,364)	(26%)
Municipal sales and use tax	3,944,962	4,118,895	(173,933)	(4%)
Grants and contributions not restricted to specific programs	8,843,513	6,945,776	1,897,737	27%
Other local taxes	1,555,196	1,251,761	303,435	24%
Interest and investment earnings	552,133	289,624	262,509	91%
Miscellaneous	1,232,175	1,012,059	220,116	22%
Total revenues	67,502,816	63,638,427	3,864,389	6%
Expenses:				
General government	32,918,744	23,301,065	9,617,679	41%
Public safety	4,073,841	4,046,537	27,304	1%
Public works	7,034,786	10,385,827	(3,351,041)	(32%)
Health and welfare	19,135,416	18,416,496	718,920	4%
Culture and recreation	2,470,695	1,439,456	1,031,239	72%
Economic development	-	9,220	(9,220)	(100%)
Community development	1,925,170	3,207,926	(1,282,756)	(40%)
Urban development	220,477	1,180,926	(960,449)	(81%)
Education	375,922	346,249	29,673	9%
Interest on long-term debt	2,594,145	2,159,360	434,785	20%
Total expenses	70,749,196	64,493,062	6,256,134	10%
Change in net assets	(3,246,380)	(854,635)	(2,391,745)	(280%)
Net assets beginning of year, as restated	70,410,508	71,265,143	(854,635)	
Net assets, end of year	<u>\$ 67,164,128</u>	<u>\$ 70,410,508</u>	<u>\$ (3,246,380)</u>	(5%)

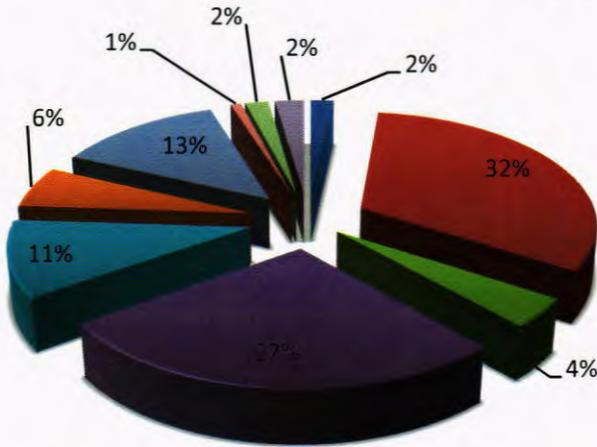
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2011

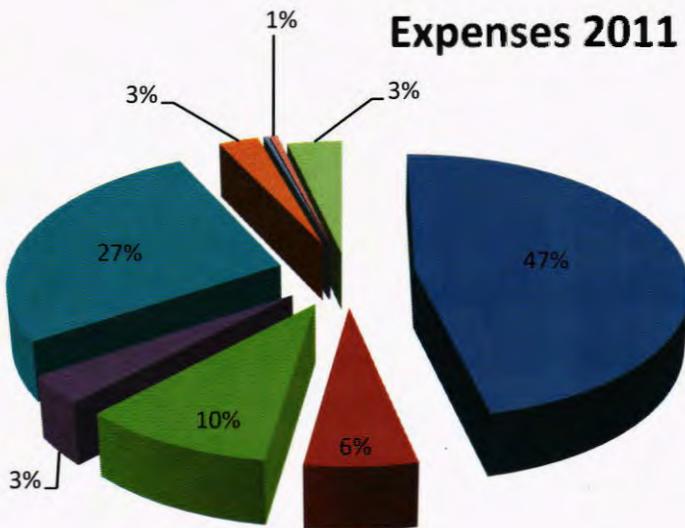
FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Revenues 2011



- Charges for Services
- Operating Grants and Contributions
- Capital Grants and Contributions
- Property Taxes
- Municipal License Tax
- Municipal Sales and Use Tax
- Grants and Contributions Not Restricted to Specific Programs
- Interest and Investment Earnings
- Miscellaneous
- Other local taxes

Expenses 2011



- General government
- Public safety
- Public works
- Culture and recreation
- Health and welfare
- Community development
- Urban development
- Education
- Interest on long-term debt

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2011

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$24,438,615, an increase of \$6,193,350 in comparison with the prior year, as restated. There are reservations of fund balance amounting to \$35,952,909. Out of the indicated balance, \$925,624 were classified as nonspendable. The combined fund balances include restricted fund balance amounting to \$33,733,754. This is the portion of fund balance that reflects resources that are subject to externally enforceable legal restrictions, 1) to pay for specific program purposes \$1,635,644, 2) to pay debt service \$9,425,380, 3) to pay for capital projects \$22,665,206, and 4) for other purposes \$7,524. There are committed fund balance amounting to \$1,293,531 that can only be used pursuant to constraint formally imposed by the Municipal Legislature by ordinances and resolutions, the \$844,660 are completely to pay for capital projects and the \$448,871 to pay for specific programs purpose. Also, there are unassigned deficit amounts of \$(10,081) and \$(213,621), in the capital projects fund and other governmental funds, respectively.

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2011, the general fund has an unassigned fund deficit of \$(11,290,592).

GENERAL FUND BUDGETARY HIGHLIGHTS

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

The actual General Fund budgetary activities resulted in an unfavorable balance of \$2,044,202 caused mainly by unfavorable variances in collections.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2011

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2011, amounts to \$164,248,895, which upon deduction of accumulated depreciation of \$42,387,750; produce a net book value of \$121,861,145. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2011, the Municipality has \$13,341,006 of unexpended proceeds mainly from bond and notes issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a Municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2011

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2011-2012.

FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others.

The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

Act No. 94 issued on June 16, 2011 by the Legislature established an incentive plan for the payment of real and personal property tax dues, beginning on July 14, 2011. This Act provides an amnesty to all property tax payers forgiving all penalties, charges and interests of the unpaid principal of pass-due property tax liability. The period that tax payers have to enjoy for such benefit is for exactly ninety (90) days beginning on July 14 through October 11, 2011. The unpaid property taxes covered under this Act are those related to fiscal year 2009-2010 and earlier (for real property taxes) and for 2008 and earlier for personal property tax.

On September 14, 2011, the **Municipality of Arecibo** issued a special obligation bond for the amount of \$2,065,000, charged to the Municipal Redemption Fund, for the repayment of Retirement System Administration debt. Repayment of the bond is scheduled from July 2012 through July, 2036.

On December 27, 2011, the **Municipality of Arecibo** issued a general obligation note for the amount of \$5,775,000, for the payment of operational debts. Repayment of the bond is scheduled from July 2012 through July, 2018

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2011

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at PO Box 1086, Arecibo, Puerto Rico 00613, or call (787) 878-5612.

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Net Assets
June 30, 2011

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 10,643,128
Cash with fiscal agent	22,699,821
Accounts receivable:	
Municipal sales tax	250,541
Intergovernmental	74,089
Federal grants	1,003,727
Others	20,960
Note receivable	909,150
Capital assets	
Land, improvements, and construction in progress	63,538,192
Other capital assets, net of depreciation	58,322,953
Total capital assets	<u>121,861,145</u>
Total assets	<u>157,462,561</u>
Liabilities	
Accounts payable and accrued liabilities	8,783,194
Due to other governmental entities	407,015
Deferred revenues:	
Municipal license tax	53,514
Federal grant revenues	1,147,652
Interest payable	1,048,324
Noncurrent liabilities:	
Due within one year	10,514,118
Due in more than one year	68,344,616
Total liabilities	<u>90,298,433</u>
Net Assets	
Invested in capital assets, net of related debt	89,856,145
Restricted for:	
Capital projects	23,499,785
Debt service	8,377,056
Other purposes	2,804,042
Unrestricted (deficit)	<u>(57,372,900)</u>
Total net assets	<u>\$ 67,164,128</u>

**Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Activities
For the Year Ended June 30, 2011**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$32,918,744	\$ 746,835	\$ 960,042	\$ -	\$ (31,211,867)
Public safety	4,073,841	89,600	224,973		(3,759,268)
Public works	7,034,786	207,691	1,170,012	470,835	(5,186,248)
Health and welfare	19,135,416		18,906,479		(228,937)
Culture and recreation	2,470,695	181,622	150		(2,288,923)
Community development	1,925,170			2,311,138	385,968
Urban development	220,477		60,080		(160,397)
Education	375,922		503,990		128,068
Interest on long-term debt	2,594,145				(2,594,145)
Total governmental activities	\$70,749,196	\$ 1,225,748	\$21,825,726	\$ 2,781,973	(44,915,749)
General revenues:					
					18,266,463
					7,274,927
					3,944,962
					1,555,196
					8,843,513
					552,133
					1,232,175
					<u>41,669,369</u>
					(3,246,380)
					<u>70,410,508</u>
					<u>\$ 67,164,128</u>

Commonwealth of Puerto Rico
Municipality of Arecibo
Balance Sheet
Governmental Funds
June 30, 2011

	General Fund	Special Revenue Fund Head Start	Special Revenue Fund Other Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ -	\$ 743,800	\$ 714,560	\$ 6,810,920	\$ -	\$ 2,373,848	\$ 10,643,128
Cash with fiscal agent	7,524			13,341,006	9,351,291		22,699,821
Accounts receivable:							
Municipal sales tax	250,541						250,541
Intergovernmental					74,089		74,089
Federal grants			1,003,727				1,003,727
Others	20,960						20,960
Advances from other funds	925,624						925,624
Due from other funds	691,621			4,574,560			5,266,181
Total assets	\$ 1,896,270	\$ 743,800	\$ 1,718,287	\$ 24,726,486	\$ 9,425,380	\$ 2,373,848	\$ 40,884,071
Liabilities and Fund Balances							
Liabilities :							
Accounts payable and accrued liabilities	\$ 1,150,740	\$ 46,396	\$ 324,950	\$ 913,066	\$ -	\$ 5,198	\$ 2,440,350
Bank overdraft	6,169,120						6,169,120
Claims and judgements	36,000						36,000
Due to other governmental entities	407,015						407,015
Advances to other funds			593,736			331,888	925,624
Due to other funds	4,437,325	7,324	342,029	313,635		165,868	5,266,181
Deferred revenues:							
Municipal license tax	53,514						53,514
Federal grant revenues		690,080	457,572				1,147,652
Total liabilities	12,253,714	743,800	1,718,287	1,226,701	-	502,954	16,445,456
Fund balances:							
Nonspendable	925,624						925,624
Restricted	7,524			22,665,206	9,425,380	1,635,644	33,733,754
Committed				844,660		448,871	1,293,531
Unassigned	(11,290,592)			(10,081)		(213,621)	(11,514,294)
Total fund balances	(10,357,444)	-	-	23,499,785	9,425,380	1,870,894	24,438,615
Total liabilities and fund balances	\$ 1,896,270	\$ 743,800	\$ 1,718,287	\$ 24,726,486	\$ 9,425,380	\$ 2,373,848	\$ 40,884,071

Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2011

	General Fund	Special Revenue Fund Head Start	Special Revenue Fund Other Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues							
Property taxes	\$ 11,962,344	\$ -	\$ -	\$ -	\$ 6,304,119	\$ -	\$ 18,266,463
Municipal license taxes	7,274,927						7,274,927
Municipal sales taxes	3,176,320				768,642		3,944,962
Licenses, permits and other local taxes	1,655,196						1,655,196
Charges for services	205,525					6,055	211,580
Intergovernmental	9,803,556			1,230,835		663,322	11,697,713
Fines and forfeitures	89,600						89,600
Rent of property	716,877			207,691			924,568
Interest	552,133						552,133
Federal grants		11,676,698	5,458,449			4,618,352	21,753,499
Miscellaneous	1,132,175						1,132,175
Total revenues	36,568,653	11,676,698	5,458,449	1,438,526	7,072,761	5,287,729	67,502,816
Expenditures							
Current:							
General government	25,183,086			754,374		15	25,937,475
Public safety	3,820,418		111,350			52,126	3,983,894
Public works	6,692,259			4,148,110			10,840,369
Health and welfare		11,676,698	2,910,214			4,599,244	19,186,156
Culture and recreation	1,687,037			45,617			1,732,654
Economic development							
Community development			2,311,138				2,311,138
Urban development			75,079	145,397			220,476
Education						370,840	370,840
Debt service:							
Principal					2,696,000		2,696,000
Interest					2,318,464		2,318,464
Total expenditures	37,382,800	11,676,698	5,407,781	5,093,498	5,014,464	5,022,225	69,597,466
Excess (deficiency) of revenues over (under) expenditures	(814,147)		50,668	(3,654,972)	2,058,297	265,504	(2,094,650)
Other financing sources (uses)							
Transfers in	102,000		7,332	6,124	1,070,535		1,185,991
Transfers out	(1,083,991)		(58,000)	(44,000)			(1,185,991)
Long-term debt issued	2,095,000			6,193,000			8,288,000
Total other financing sources (uses)	1,113,009		(50,668)	6,155,124	1,070,535		8,288,000
Net change in fund balances	298,862			2,500,152	3,128,832	265,504	6,193,350
Fund balance, beginning as restated	(10,656,306)			20,999,633	6,296,548	1,605,390	18,245,265
Fund balance, ending	<u>\$ (10,357,444)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,499,785</u>	<u>\$ 9,425,380</u>	<u>\$ 1,870,894</u>	<u>\$ 24,438,615</u>

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Commonwealth of Puerto Rico
Municipality of Arecibo
Reconciliation of the Balance Sheet - Governmental Funds
to the Statement of Net Assets
For the Year Ended June 30, 2011

Total Fund Balances - Governmental Funds \$ 24,438,615

Amounts reported for Governmental Activities in the Statement of Net Assets are different because:

Capital Assets used in governmental activities are not financial resources and therefore, are not reported in the funds. In the current period, these amounts are:

Non Depreciable Capital Assets	\$ 63,538,192	
Depreciable Capital Assets, net of depreciation	<u>58,322,953</u>	
Total Capital Assets		121,861,145

Other assets are not available to pay for current period expenditures and therefore are deferred in the funds:

Notes receivable	909,150
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Some liabilities are not due and payable in the current period and therefore, are not reported in the funds. Those liabilities consist of:

General bonds and notes payable	55,739,000	
Construction in progress accounts payables	137,724	
Landfill obligation	8,174,679	
LIMS repayment plan	106,566	
Property taxes debt	4,323,720	
Compensated absences	5,121,063	
Interest payable	1,048,324	
Aqueduct and Sewer Authority Debt	666,569	
Waste Disposal Contracts Debt re-payment	1,886,186	
Department of Labor Debt	125,178	
Retirement system administration Debt	2,535,418	
Claims and judgment	<u>180,355</u>	
Total Long-Term Liabilities		<u>(80,044,782)</u>

Total Net Assets of Governmental Activities \$ 67,164,128

Commonwealth of Puerto Rico
Municipality of Arecibo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2011

Net Change in Fund Balances - Total Governmental Funds \$ 6,193,350

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.	5,745,557
Governmental Funds report capital assets sold as revenues. However, in the Government-Wide Statement of Activities and Changes in Net Assets, Disposal of capital assets require removal of cost of the capital assets from the capital assets account on the Government-Wide Statement of Net Assets.	(3,476)
Depreciation Expense on Capital Assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, Depreciation expense is not reported as expenditures in Governmental Funds Financial Statements.	(3,191,794)
Interest Expense change is reported in the Government-Wide Statement of Activities and Change in Net Assets, but not require the use of current financial resources. Therefore, Interest expense change is not reported as expenditures in Governmental Funds Financial Statements.	(275,681)
Accounts payable change reported in the Government-Wide Statement of Activities and Change in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. This is the amount reported in the current period.	282,870
Long term debt issuances are reported in the Government-Wide Statement of Net Assets, but not require the use of current financial resources. Therefore, Long term debt issuances are not reported as expenditures in Governmental Funds Financial Statements.	(9,425,425)
Long term debts payments are reported as expenditures in the Governmental Funds Financial Statements which require the use of current financial resources. Therefore Long term debt payments are not reported as expenditures in the Government-Wide Statement of Activities and Change in Net Assets.	5,579,732
Change in Landfill Accrual	136,487
Bonds proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bond principal is an expenditure in Governmental Funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt service principal payments exceed debt proceeds.	(8,288,000)
Change in Net Assets of Governmental Activities	<u><u>\$ (3,246,380)</u></u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Arecibo** (the Municipality) was founded on the year 1515. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a sixteen member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The basic financial statements of the Municipality have been prepared in conformity with Generally Accepted Accounting Principles as applied to local governmental units in the United States of America (US GAAP).

The Municipality's basic financial statements consist of government-wide statements, including a statement of net assets and a statement of activities, and fund financial statements, which provide a more detailed level of financial information.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year 2007. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

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

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

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

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, *The Financial Reporting Entity*, of the GASB. As amended by the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units, an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. USGAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

A. Component Units (Continued)

“Corporación Desarrollo Cultural Teatro Oliver C.E.” is a non-profit organization duly organized and existent under the laws of the Commonwealth of Puerto Rico. It was established to acquire, restore and operate the Teatro Oliver of Arecibo, Puerto Rico.

The Municipality management determined as a component unit the operations of Teatro Oliver, because of the financial interdependency, ability to designate management and the ability to significantly influence operations demonstrated by the Municipality. The Theater funds becomes from private and municipal donations and the rent of the facilities.

The “Corporación Desarrollo Cultural Teatro Oliver C.E.” elected the provision of Section 101 (7) of the Puerto Rico Income Tax Law for non-profit organization and all of their net revenues are exempt from the payment of income taxes.

B. Government-wide and fund financial statements

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

1. Management’s discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality’s financial activities.

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers of applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

B. Government-wide and fund financial statements (Continued)

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

Special Revenue Fund – Head Start is a major governmental fund used to account for and report the proceeds of revenues derived from the head start and child adult care food program grants used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

Special Revenue Fund – Other federal grants is a major governmental fund used to account for and report the proceeds of specific federal revenue sources that are legally restricted to expenditure for specific purposes other than debt service or capital projects.

Capital Projects Fund – State and Local Grants- is a major governmental fund used to account for and report financial resources that are restricted or committed to expenditure for capital outlays, including the acquisition or construction of major capital facilities, including those outlays financed by the general obligation bond proceeds (other than those financed by proprietary funds or in trust funds for individuals, private organizations, or other governments). The use of the capital projects funds has been limited to 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.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

B. Government-wide and fund financial statements (Continued)

The outstanding balance of certain general long-term obligations for which debt service payments do not involve the advance accumulation of resources (such as certain notes payable, obligations under capital leases, accrued compensated absences, landfill obligation, claims and judgments, net pension liability and other long-term obligations) are only accounted for in the accompanying statement of net assets. The debt service payments of such obligations are generally accounted for in the governmental fund which accounted for the financial resources used for the payment of such debts. Principal and interest due on July 1 of the following fiscal year are accounted for as a fund liability, if resources are available as of June 30 for its payment.

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

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

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund – Is the operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund – Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

C. Financial reporting presentation (Continued)

sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Section 8 - Special Revenue Fund used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Head Start- Is the accounting entity in which revenues derived from the federal agency are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

Special Revenue Fund - Other Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Funds - Local, State and Federal Grants - Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

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

D. Measurement focus, basis of accounting and financial presentation

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

D. Measurement focus, basis of accounting and financial presentation (Continued)

permits, charges for services, and most miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received.

The Municipality groups its non-exchange transactions into the following four (4) classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

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

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 non-governmental entities, including individuals, other than assessments on exchange transaction, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license taxes are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used for the first fiscal year that the use of the resources is permitted.

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

For voluntary non-exchange transactions (such as donations and certain grants and entitlements) receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above. Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been occurred and the amount of loss is reasonably estimated.

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2011. Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

D. Measurement focus, basis of accounting and financial presentation (Continued)

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

Government Fund Financial Statements – The accompanying GFFS are reported using the current financial resources measurements focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal licenses taxes, construction excise taxes, sales and use taxes, interests on deposits, intergovernmental grants and contributions and certain charges for services) to be available if collected within sixty (60) days after June 30, 2011. At June 30, 2011, all revenues sources met this availability criterion.

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

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

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange, exchange-like transactions are also generally recorded when the exchange takes place while all revenues, expenses, gains, losses, and assets resulting from non-exchange transactions are recorded when an enforceable legal claim arises or when all eligibility requirements imposed by the provider have been met, applicable.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

D. Measurement focus, basis of accounting and financial presentation (Continued)

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2011.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. The accompanying Balance Sheet – Governmental Funds generally reflects only assets that will be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying Balance Sheet – Governmental Funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying Balance Sheet – Governmental Funds.

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

E. Assets, liabilities and net assets

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivable in the general fund relates mostly to Law 52 proposal payroll reimbursements from prior years and property taxes owed by the Municipal Revenue Collection Center ("CRIM"). Intergovernmental receivable in the debt service fund represent property taxes owed by the Municipal Revenue Collection Center ("CRIM").

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

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

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

<u>Description</u>	<u>Useful Life</u>	<u>Capitalization threshold</u>
Buildings and site improvements	40 years	\$1
Infrastructure	40 years	\$1
Works of art	10 years	\$1
Vehicles	5 years	\$1
Furniture and fixtures	5 years	\$25
Machinery and equipment	3 to 5 years	\$25

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

5. Deferred revenues- In the GFFS, deferred revenues arises when one of the following situations occur:

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

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

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

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

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

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

8. Claims and judgments- The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund when the liability is incurred.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

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

Pursuant to the provisions of GASB No. 54, the accompanying GFFS report fund balance amounts that are considered restricted, committed, assigned, and unassigned, based on the relative strength of the 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, no later than the end of fiscal year.
- d. *Unassigned* – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balances amounts as of for the fiscal year ended June 30, 2011.

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

10. Net Assets - Restricted net assets have been reported pursuant to the provisions of GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). Those net assets consist of net resources restricted by external parties (such as debt covenants, creditors, grantors, contributions, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by the constitutional provisions or enabling legislation.

Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. A legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. The Municipality periodically reevaluates the legal enforceability of an enabling legislation to determine if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration.

The classification of restricted net 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 designation 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

In the government-wide statements, net assets are segregated into three categories:

- a. *Invested in capital assets, net of related debt*: Consist of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital assets acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
- b. *Restricted net assets*: Represent net assets that are subject to restrictions beyond the Municipal's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
- c. *Unrestricted net assets*: Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face statement of net assets.

11. Accounting for Pension Costs- On July 1, 2007, the Municipality adopted the provisions of GASBS No. 50, *Pension Disclosure*, which amended GASBS No.27, *Accounting for Pensions by State and Local Government Employers*, by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

The Municipality accounts for pension costs from the standpoint of a participant in a multi-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.

For the purpose of applying the requirements of GASBS No. 27, the state government of the Government 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 Government of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

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

- a. Operating Transfers- Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
- b. Intra-Entity Transactions- Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

13. Risk financing – The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2011 to \$858,381. The current insurance policies have not been cancelled or terminated.

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

The Municipality obtains workers' compensation insurance through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth of Puerto Rico. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (CRIM) for the year ended June 30, 2011 amounted to \$1,058,008.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth of Puerto Rico'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 work or employment-related accidents or non-occupational disability and drivers' insurance premiums are paid directly to DOL on a cost reimbursement basis.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

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

E. Assets, liabilities and net assets (Continued)

Under Act No. 63 of June 21, 2010, the Legislative Assembly of the Commonwealth of Puerto Rico, authorized the municipalities to procure and manage at their own discretion all insurance policies, including those related to health plans been provided to the municipal employees. The Municipality also obtains medical insurance coverage from one health insurance company for its employees. Different health coverage and premium options are negotiated each year by the Municipality. Premiums are paid on a monthly basis directly to the insurance company.

14. Use of Estimates

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

2. CASH AND CASH EQUIVALENTS

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

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 and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2011.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. CASH AND CASH EQUIVALENTS (CONTINUED)

Interest rate risk – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2011, the Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2011, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

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

In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB 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. 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 – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2011.

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

The Municipality's bank balances in commercial banks of \$743,800, \$714,560, \$6,810,920, and \$2,373,848 in the special revenue fund-Head Start, special revenue fund- other federal grants, capital projects fund-local and state grant, and in other governmental funds, respectively, were fully collateralized at June 30, 2011.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. CASH AND CASH EQUIVALENTS (CONTINUED)

The deposits at GDB of \$ 7,524 in the general fund, the \$13,341,006 that are restricted principally for capital projects in the capital project fund – local and state grant, and the \$9,351,291 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

A. *Municipal Sales Tax* - On July 29, 2007, an amended to Act No. 117 of July 4, 2006, known as the "Tax Fairness Act of 2006", was enacted with the purpose of establishing a mandatory sales and use tax of 1.5% at the Municipal Level. The Municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by the Treasury Department. The Act provides an optional surtax on the un-process food. This surtax must be approved by the Municipal Legislature. The Treasury Department is responsible to create the Municipal Development Fund (.2%), the Municipal Redemption Fund (.2%) and the Municipal Improvements Fund (.1%) with the remaining 0.5%. The Municipality collected \$3,176,320 during the year ended June 30, 2011. Also, \$768,642 from the Municipal Redemption Fund are included in the debt service fund. Municipal sales and use tax receivable of \$250,541, in the general fund represents filed tax returns that were uncollected as of June 30, 2011, net of allowance for uncollectible accounts.

B. *Intergovernmental* - Intergovernmental receivable in the debt service fund represents the amounts due from the CRIM resulting from the excess of the current year property tax collections over current year advances. Following is a detail of the Intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM")	\$ <u>74,089</u>
Total	\$ <u>74,089</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

3. RECEIVABLES (CONTINUED)

- C. **Federal grants**-Federal grants receivable in the special revenue fund-other federal grants represent expenditures incurred not yet reimbursed by the Federal government. Following is a detail of the federal grants receivables:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant/Entitlement Grants	\$ 38,690
Home Program	177,898
Public Assistance Grant	265,528
Special Program for Aging - Title III	117,785
Child Care Development Block Grant Program	57,407
Community Service Block Grant	19,566
ARRA-Child Care Development Block Grant Program	13,160
Even Start Family Literacy Program	25,241
Transit Capital Assistance Grants-Urbanized Area Funding Program	75,509
Homeland Security Grant Program	192,301
Others	<u>20,642</u>
Total	<u>\$ 1,003,727</u>

- D. **Note Receivable**- In August 2005, the Municipal Legislature authorized the Mayor to sell the Puerto Rico Distiller facilities for a sale price of \$3,000,000. In the prior years, the Municipality collected a down payment of \$150,000.

The buyer could at any time make payments of the remaining balance of the note receivable of \$2,850,000, during the term of ten years, as stipulated by contract. The payments could be divided depending of the development of the project phases or could be made in a single payment as long as it is in the established term. During fiscal year 2008-2009, the buyer paid \$1,940,850. The remaining receivable amounts to \$909,150.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2011, and interfund transfers during the fiscal year ended at June 30, 2011, are summarized as follows:

a. Due from/to other fund and Advances to/from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Special Revenue Fund-other federal grants	Payroll and related accruals paid and not reimbursed	\$ 935,765
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	360,521
General Fund	Special Revenue Fund-Head Start Fund	Payroll and related accruals paid and not reimbursed	7,324
General Fund	Capital Projects Funds	Reimbursable Expenditures	313,635
Capital Projects Fund	Other Governmental Funds	Reimbursable Expenditures	137,235
Capital Projects Fund	General Fund	Reimbursable transfer of funds	<u>4,437,325</u>
Total			<u>\$ 6,191,805</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$ 1,070,535
General Fund	Special Revenue Fund-other federal grants	In-kind Cash Contribution	7,332
General Fund	Capital Projects Fund	Transfer of funds for special purpose	6,124
Special Revenue Fund-other federal grants	General Fund	Reimbursement of funds	58,000
Capital Project Fund	General Fund	Reimbursement of funds	<u>44,000</u>
Total			<u>\$ 1,185,991</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

5. CAPITAL ASSETS

Capital assets; those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2011, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance July 1, 2010</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2011</u>
Capital asset, not being depreciated:				
Construction in progress	\$ 4,960,125	\$ 4,298,791	\$ (416,829)	\$ 8,842,087
Land	<u>54,696,105</u>	<u>-</u>	<u>-</u>	<u>54,696,105</u>
Total capital assets not being depreciated	<u>59,656,230</u>	<u>4,298,791</u>	<u>(416,829)</u>	<u>63,538,192</u>
Capital assets, being depreciated:				
Buildings	\$ 45,914,666	-	-	\$ 45,914,666
Buildings improvements	11,677,086	122,385	-	11,799,471
Infrastructure	16,957,618	-	-	16,957,618
Infrastructure improvements	7,999,291	941,316	-	8,940,607
Equipment	4,854,446	258,316	(90,276)	5,022,486
Furnishing	1,749,670	62,534	(7,332)	1,804,872
Computers	1,032,553	63,350	(41,856)	1,054,047
Works of Art	157,261	-	-	157,261
Vehicles	<u>8,644,100</u>	<u>415,694</u>	<u>(119)</u>	<u>9,059,675</u>
Total capital assets being depreciated	<u>98,986,691</u>	<u>1,863,595</u>	<u>(139,583)</u>	<u>100,710,703</u>
Less accumulated depreciation for:				
Buildings	(11,995,262)	(1,147,867)	-	(13,143,129)
Buildings improvements	(1,410,543)	(292,483)	-	(1,703,026)
Infrastructure	(10,825,027)	(172,563)	-	(10,997,590)
Infrastructure improvements	(1,265,365)	(585,092)	-	(1,850,457)
Equipment	(3,772,372)	(364,864)	87,178	(4,050,058)
Furnishing	(1,609,342)	(49,784)	6,954	(1,652,172)
Computers	(723,933)	(165,852)	41,856	(847,929)
Work of Art	(140,380)	(2,755)	-	(143,135)
Vehicles	<u>(7,589,839)</u>	<u>(410,534)</u>	<u>119</u>	<u>(8,000,254)</u>
Total accumulated depreciation	<u>(39,332,063)</u>	<u>(3,191,794)</u>	<u>136,107</u>	<u>(42,387,750)</u>
Total capital assets being depreciated, net	<u>59,654,628</u>	<u>(1,328,199)</u>	<u>(3,476)</u>	<u>58,322,953</u>
Governmental activities capital assets, net	<u>\$119,310,858</u>	<u>\$ 2,970,592</u>	<u>\$ (420,305)</u>	<u>\$121,861,145</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General Government	\$ 736,567
Public Safety	180,494
Public Works	802,722
Health and Welfare	15,875
Culture and Recreation	880,447
Economic Development	152
Community Development	570,455
Education	<u>5,082</u>

Total depreciation expense-governmental activities **\$ 3,191,794**

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2011 are summarized as follows:

<u>Description</u>	<u>General Fund</u>	<u>Special Revenue Fund - Head Start</u>	<u>Special Revenue Fund - Other Federal Funds</u>	<u>Capital Projects Fund - State & Local Grants</u>	<u>Debt Service Fund</u>	<u>Other Governmental Fund</u>	<u>Total</u>
Accounts payable	\$ 894,861	\$ 46,396	\$ 324,950	\$ 913,066	\$ -	\$ 5,198	\$ 2,184,471
Accrued liabilities	<u>255,879</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>255,879</u>
Total	<u>\$ 1,150,740</u>	<u>\$ 46,396</u>	<u>\$ 324,950</u>	<u>\$ 913,066</u>	<u>\$ -</u>	<u>\$ 5,198</u>	<u>\$ 2,440,350</u>

7. DUE TO OTHER GOVERNMENTAL ENTITIES

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

<u>Governmental Entity</u>	<u>Amount</u>
General Services Administration	\$ 175
Treasury Department	129,348
Puerto Rico Aqueduct and Sewer Authority	<u>277,492</u>
Total	<u>\$ 407,015</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

8. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of \$53,514 in the general fund relates to municipal license tax collected in fiscal year 2010-11 that will be earned in fiscal year 2011-12.
- B. Federal Grants-** The deferred revenues presented in special revenue fund-Head Start program represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child Care Food Program	\$ 230,653
Head Start Program	459,397
ARRA-Head Start Program	<u>30</u>
Total	<u>\$ 690,080</u>

The deferred revenues presented in special revenue fund-other federal grants represent the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Rural Development Corporation	\$ 162,000
Urban Development Action Grant	37,524
ARRA-Emergency Shelter	43,304
Public Assistance Grant	181,862
Other	<u>32,882</u>
Total	<u>\$ 457,572</u>

9. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

9. PROPERTY TAXES (CONTINUED)

Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers

This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. As of June 30, 2011, the CRIM issued the final settlement noting that advances exceeded collections by \$2,285,407. This balance will be retained by the CRIM during fiscal year 2012-2013. Those amounts are presented in the government wide financial statements.

On January 26, 2000, Public Law No. 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000.

The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2002, Public Law No. 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law No. 42 enacted on January 26, 2000.

On June 26, 1997, Public Law No. 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

9. PROPERTY TAXES (CONTINUED)

A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law No. 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

The government-wide statement of net assets includes an outstanding balance of \$1,117,503 and \$920,810 related to Law No. 42 and Law No. 146, respectively.

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

The annual tax rate is 8.58% for real property and 6.58% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund.

A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2011, was as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds Payable	\$ 50,147,000	\$ 6,235,000	\$ (2,696,000)	\$ 53,686,000	\$ 2,965,000
Notes Payable	-	2,053,000		2,053,000	234,000
LIMS Repayment Plan	310,552		(203,986)	106,566	106,566
Property Tax Debt - Law 42	1,141,910		(24,407)	1,117,503	25,941
Property Tax Debt - Law 146	964,658		(43,848)	920,810	43,848
CRIM Final Liquidation 2008-2009	531,014	65,427	(596,441)		
CRIM Final Liquidation 2007-2008	160,947		(160,947)		
CRIM Final Liquidation 2010-2011		2,285,407		2,285,407	
Compensated Absences	5,223,990	570,693	(673,620)	5,121,063	1,745,057
Landfill Obligation	8,311,166		(136,487)	8,174,679	
Retirement System Administration Payment Plan	-	2,535,418		2,535,418	2,535,418
PR Aqueduct and Sewer Authority- Payment Plan	-	666,569		666,569	666,569
Waste Disposal Contract Debt	-	1,886,186		1,886,186	1,886,186
Department of Labor Debt	-	125,178		125,178	125,178
Claims and Judgments	<u>165,811</u>	<u>1,355,973</u>	<u>(1,341,429)</u>	<u>180,355</u>	<u>180,355</u>
Total	<u>\$66,957,048</u>	<u>\$17,778,851</u>	<u>\$ (5,877,165)</u>	<u>\$78,858,734</u>	<u>\$ 10,514,118</u>

- 1. Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. In addition, before any new bonds are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds and notes payable (excluding notes payable to the Land Authority), is paid with unrestricted funds.
- 2. Bonds Payable-** The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities and for the liquidation of operational debts. Bonds payable outstanding at June 30, 2011 are as follows:

<u>Description</u>	<u>Balance at June 30, 2011</u>
2010 General obligation bond for operational expenses with an original amount of \$ 805,000 due in installments of \$25,000 to \$85,000 through July 1, 2025, with interest ranging from 4.75% to 7.50%.	\$ 780,000
1988 Public works bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$875,000 due in installments of \$60,000 to \$63,000 through July 1, 2012, with interest of 5.00%.	63,000
1990 Public Works bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$500,000 due in installments of \$30,000 to \$40,000 through July 1, 2014, with interest of 5.00%.	105,000
2010 General obligation bond for operational expenses with an original amount of \$ 1,355,000 due in installments of \$30,000 to \$125,000 through July 1, 2030, with interest ranging from 6.00 % to 7.50%.	1,325,000
1995 Public Works bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$400,000 due in installments of \$20,000 to \$30,000 through July 1, 2019, with interest of 4.87%.	202,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

10. LONG-TERM LIABILITIES (CONTINUED)

Description	Balance at June 30, 2011
1996 Public Works bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$14,975,000 due in installments of \$600,000 to \$1,300,000 through July 1, 2021, with interest ranging from 6.30% to 6.63%.	9,420,000
1998 General obligation bond for operational expenses with an original amount of \$ 900,000 due in installments of \$33,000 to \$64,000 through July 1, 2023, with interest of 4.75%.	582,000
2000 General obligation bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$7,365,000 due in installments of \$225,000 to \$615,000 through July 1, 2025, with interest ranging from 4.30% to 5.60%.	5,610,000
2002 Special obligation bond for operational expenses with an original amount of \$10,545,000 due in installments of \$290,000 to \$920,000 through July 1, 2026, with interest ranging from 3.68% to 8.00%.	8,460,000
2002 General obligation bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$5,030,000 due in installments of \$130,000 to \$420,000 through July 1, 2027, with interest ranging from 4.30% to 5.60%.	4,130,000
2003 Special obligation bond for operational expenses with an original amount of \$4,235,000 due in installments of \$115,000 to \$315,000 through July 1, 2028, with interest of 6.00%.	3,480,000
2004 General Obligation bond for operational expenses with an original amount of \$360,000 due in installments of \$40,000 to \$45,000 through July 1, 2014, with interest ranging from 1.54% to 6.00%.	130,000
2004 General obligation bond for operational expenses with an original amount of \$605,000 due in installments of \$15,000 to \$50,000 through July 1, 2029, with interest ranging from 1.54% to 6.00%.	515,000
2004 Special obligation bond for operational expenses with an original amount of \$294,000 due in installments of \$34,000 to \$36,000 through July 1, 2013, with interest of 6.00%.	72,000
2004 General obligation bond "Mejoras Coliseo" for acquisition of capital assets and infrastructure characteristics with an original amount of \$410,000 due in installments of \$25,000 to \$35,000 through July 1, 2020, with interest ranging from 4.50% to 4.73%.	275,000
2004 General Obligation bond "Plaza Mercado" for acquisition of capital assets and infrastructure characteristics with an original amount of \$1,610,000 due in installments of \$45,000 to \$105,000 through July 1, 2030, with interest ranging from 1.54% to 4.00%.	1,355,000
2005 General obligation bond for operational expenses with an original amount of \$7,670,000 due in installments of \$780,000 to \$950,000 through July 1, 2015, with interest ranging from 1.54% to 5.50%.	3,525,000
2007 General obligation bond for operational expenses with an original amount of \$1,056,000 due in installments of \$94,000 to \$141,000 through July 1, 2017, with interest ranging from 1.54% to 7.00%.	717,000
2009 General obligation bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$1,015,000 due in installments of \$15,000 to \$85,000 through July 1, 2034, with interest ranging from 1.56% to 7.50%.	990,000
2009 General obligation bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$4,020,000 due in installments of \$65,000 to \$335,000 through July 1, 2034, with interest ranging from 4.75% to 7.50%.	3,895,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

10. LONG-TERM LIABILITIES (CONTINUED)

Description	Balance at June 30, 2011
2009 Special obligation bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$1,845,000 due in installments of \$25,000 to \$155,000 through July 1, 2035, with interest ranging from 5.00% to 7.50%.	1,820,000
2010 Special obligation bond for acquisition of capital assets and infrastructure characteristics with an original amount of \$4,140,000 due in installments of \$65,000 to \$335,000 through July 1, 2036, with interest ranging from 6.50% to 7.00%.	4,140,000
2010 Special obligation bond for payment of operational debts with an original amount of \$2,095,000 due in installments of \$25,000 to \$175,000 through July 1, 2036, with interest ranging from 6.50% to 7.00%.	2,095,000
Total	\$ 53,686,000

These bonds, except 2001-Series amounting to 10,545,000, 2003-Series amounting to 4,235,000 and 2004-Series amounting \$294,000 are payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. In addition, the Series 2009, amounting 1,845,000, and the Series 2010 amounting to \$4,140,000 and \$2,095,000, are payable with the revenues generated from the collection of the .0002% of the municipal sales and use taxes Redemption Fund.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 2,965,000	\$ 2,764,418
2013	3,112,000	3,266,485
2014	3,297,000	3,072,379
2015	3,414,000	2,866,621
2016	2,651,000	2,678,013
2017-2021	15,782,000	10,549,827
2022-2026	12,990,000	5,755,909
2027-2031	5,520,000	2,314,598
2032-2036	3,955,000	644,688
Total	\$ 53,686,000	\$ 33,912,938

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

10. LONG-TERM LIABILITIES (CONTINUED)

- 3. Notes Payable-** The proceeds of the issuance of notes payables were used principally to cover the expenditures of a special event, such as capital projects and real property acquisitions. The notes are payable as follows:

<u>Type of notes</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Range of Interest rates</u>	<u>Balance at June 30, 2011</u>
2011 Series	7-01-18	\$ 825,000	6% to 7.5%	\$ 825,000
2011 Series	7-01-18	1,228,000	6.50% to 7.50%	<u>1,228,000</u>
Total notes payable				<u>\$ 2,053,000</u>

The first 2010 Series note is payable from the ad valorem property tax of 1.75% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. The other Series 2010, amounting 1,228,000, is payable with the revenues generated from the collection of the .0002% of the municipal sales and use taxes Redemption Fund.

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 234,000	\$ 97,524
2013	250,000	121,980
2014	271,000	105,165
2015	289,000	86,512
2016	312,000	63,938
2017-2021	<u>697,000</u>	<u>53,212</u>
Total	<u>\$ 2,053,000</u>	<u>\$ 528,331</u>

- 4. LIMS Repayment Plan-** During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System - LIMS, contracted by the CRIM. A total of \$1,636,386 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2011, the outstanding debt balance is \$106,566. This amount is presented in the government wide financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

10. LONG-TERM LIABILITIES (CONTINUED)

5. **Property Tax Debt-** These amounts represent the balance owed to the Municipal Revenue Collection Center (CRIM) at June 30, 2011, as described in Note 9.
6. **Compensated Absences-** The government-wide statement of net assets includes \$2,222,632 of accrued sick leave benefits, and \$2,898,431 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
7. **Landfill obligation-** State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on the future closure and post-closure care cost that will be incurred near or after the date the landfill no longer accepts waste. The recognition of these landfill closure and post-closure care costs is based on the amount of landfill used during the year. During the fiscal year 2010-2011, the landfill administration made some capital improvements that changed the estimate. The estimated liability for landfill closure and post-closure care costs has a balance of \$8,174,679 as of June 30, 2011 reported in the Government-Wide Financial Statements, which is based on 58% usage (filled) of the landfill. It is estimated that an additional \$3,825,321 will be recognized as closure and post-closure care expenses between the date of the balance sheet and the date the landfill is expected to be filled to capacity (2032). The estimated total current cost of the landfill closure and post-closure care (\$12,000,000) is based on the amount that would be paid if all equipment, facilities and services required to close, monitor, and maintain the landfill were acquired as of June 30, 2011. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. The **Municipality of Arecibo** maintains \$209,665 in a bank account held for landfill improvements, and has a balance due from the general fund of \$250,000.
8. **Puerto Rico Aqueduct and Sewer Authority payment plan-** These amount represent balance owed for services to the Municipality.
9. **Waste Disposal Contracts Debt-** - These amounts represent unpaid invoices from several waste disposal contractors at June 30, 2011.
10. **Department of Labor Debt-** - These amounts represent the balance owed to the Agency for various quarterly reports not paid as of June 30, 2011.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

10. LONG-TERM LIABILITIES (CONTINUED)

11. Retirement System Administration Debt - These amounts represent the balance owed to the agency as of June 30, 2011.

12. Claims and Judgments- These amounts represent the balance related to legal claims at June 30, 2011, as described in Note 16.

11. OPERATING LEASES

The Municipality is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in the Municipality's account groups.

The following is a schedule by years of future minimum rental payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2011:

<u>Year Ending</u> <u>June 30,</u>	<u>Total</u>
2012	\$ 516,562
2013	172,402
2014	114,903
2015	<u>67,143</u>
Total minimum payments required	\$ <u>871,010</u>

12. COMPONENT UNIT

"Corporación Desarrollo Cultural Teatro Oliver, C.E."

Nature and Organization

"Corporación Desarrollo Cultural Teatro Oliver C.E." (non-profit organization) was organized under the laws of the Commonwealth of Puerto Rico. The Corporation was established to acquire "El Teatro Oliver of Arecibo" to be restored and operated as Municipal Theater.

Component unit financial statements of "Corporación Desarrollo Cultural Teatro Oliver C.E." were not available. As result, the component unit is not included as part of the Government-Wide Financial Statements.

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

13. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Legislative Assembly of the Government of Puerto Rico. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to a deferred annuity benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions. Disability retirement benefits are available to members for occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable services.

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

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

13. PENSION PLAN (CONTINUED)

The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

If at the time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

Funding Policy

The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state and municipal contributions), are established or may be amended by law.

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600 8.275% of gross salary over \$6,600
Hired on or before April 1, 1990	8.275% of gross salary

Annual Contribution

The Municipality contributions during those years are recognized as total pension expenditures/expenses in the category of administration as follows:

<u>Fiscal year</u>	<u>Law No. 447</u>	<u>System 2000</u>
2011	\$ 287,753	\$ 490,780
2010	\$ 615,397	\$ 511,207
2009	\$ 666,683	\$ 484,688

These amounts represented the 100% of the required contribution for the corresponding year. Additionally, changes made in the types and amounts of benefits offered by special laws and cost of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2011, a copy of which can be obtained from the Retirement System, Minillas Station, PO Box 42003, San Juan, PR 00940.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

14. FUND BALANCE (DEFICIT)

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

Fund Balance (Deficit)	General Fund	Special Revenue Fund-Head Start	Special Revenue Fund-Other Federal Grants	Capital Projects Fund-State & Local Grants	Debt Service Fund	Other Governmental Funds	Total
Nonspendable	\$ 925,624	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 925,624
Restricted for:							
General Government	7,524						7,524
Culture and Recreation						3,104	3,104
Health and Welfare						1,254,969	1,254,969
Public Safety						61,431	61,431
Capital Projects				22,665,206			22,665,206
Education						121,232	121,232
Debt Service					9,425,380		9,425,380
Public Works						194,908	194,908
Committed:							
General Government						288,044	288,044
Culture and Recreation						1,055	1,055
Health and Welfare						159,772	159,772
Public Works				844,660			844,660
Unassigned	(11,290,592)			(10,081)		(213,621)	(11,514,294)
Total Fund Balance (Deficit)	<u>(\$10,357,444)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,499,785</u>	<u>\$ 9,425,380</u>	<u>\$ 1,870,894</u>	<u>\$ 24,438,615</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

15. RISK MANAGEMENT

The Property Division is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the Area of Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

16. COMMITMENTS AND CONTINGENCIES

A. Claims and lawsuits:

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of \$180,355 in the Government-Wide Financial Statements for awarded and anticipated unfavorable judgments.

B. Federal grants:

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

C. Other Commitments:

At June 30, 2011 the general fund had commitments of approximately \$4.7 million for executory purchase orders or contracts that will be honored during the subsequent year.

17. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

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

- a. 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.
- b. GASB Statement No. 61, *The Financial Reporting Entity* (GASB 61). The requirements of this statement are effective for the fiscal year commencing after June 15, 2012.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

17. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (CONTINUED)

- c. 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.
- d. GASB Statement No. 63, *Financial Reporting Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. The requirements of this statement are effective for the fiscal year commencing on December 15, 2011.
- e. GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provision (amendment to GASB Statement No. 53)*. The requirements of this statement are effective for the fiscal year commencing on June 15, 2011.

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

18. PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

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

Description	General Fund	Special Revenue Fund-Head Start Fund	Special Revenue Fund - Other Federal Grants	Capital Projects Fund-Local, State, and Federal Grants	Debt Service Fund	Other Governmental Funds	Total
Fund balance beginning	(\$11,721,254)	\$ -	\$ -	\$ 20,999,633	\$6,296,548	\$ 1,604,785	\$17,179,712
To adjust prior year waste disposal accounts payable that were paid with bond issuance during the year	1,064,948						1,064,948
Interfund transaction adjustment	-	-	-	-	-	605	605
Fund balance, beginning as restated	<u>(\$10,656,306)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,999,633</u>	<u>\$6,296,548</u>	<u>\$ 1,605,390</u>	<u>\$18,245,265</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

18. PRIOR PERIOD ADJUSTMENTS (CONTINUED)

B. GOVERNMENTAL-WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental-wide financial statements, which are reported as an adjustment to beginning net assets:

<u>Description</u>	<u>Total</u>
Net assets, beginning	\$ 69,249,435
To adjust prior year waste disposal accounts payable that were paid with bond issuance during the year	1,064,948
Interfund transaction adjustment	605
To adjust Long-Term Debt as per amounts retained by "Remesas"	<u>95,520</u>
Net assets, beginning as restated	<u>\$ 70,410,508</u>

19. SUBSEQUENT EVENTS

Act No. 94 issued on June 16, 2011 by the Legislature established an incentive plan for the payment of real and personal property tax dues, beginning on July 14, 2011. This Act provides an amnesty to all property tax payers forgiving all penalties, charges and interests of the unpaid principal of pass-due property tax liability. The period that tax payers have to enjoy for such benefit is for exactly ninety (90) days beginning on July 14 through October 11, 2011. The unpaid property taxes covered under this Act are those related to fiscal year 2009-2010 and earlier (for real property taxes) and for 2008 and earlier for personal property tax.

On September 14, 2011, the **Municipality of Arecibo** issued a special obligation bond for the amount of \$2,065,000, charged to the Municipal Redemption Fund, for the repayment of Retirement System Administration debt. Repayment of the bond is scheduled from July 2012 through July, 2036.

On December 27, 2011, the **Municipality of Arecibo** issued a general obligation note for the amount of \$5,775,000, for the payment of operational debts. Repayment of the bond is scheduled from July 2012 through July, 2018.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)
YEAR ENDED JUNE 30, 2011

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u> (Budgetary Basis) (See Note 1)	<u>Variance with</u> <u>Final Budget</u> <u>Positive</u> <u>(Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES				
Property taxes	\$ 11,014,805	\$ 11,014,805	\$ 12,511,731	\$ 1,496,926
Municipal license tax	12,060,000	12,160,000	7,274,927	(4,885,073)
Sales and use tax	3,500,000	3,500,000	2,985,245	(514,755)
Licenses, permits and other local taxes	6,911,247	5,323,981	1,655,196	(3,668,785)
Charges for service	1,040,000	1,040,000	198,985	(841,015)
Intergovernmental	8,120,739	10,640,724	7,945,172	(2,695,552)
Rent of property	300,000	300,000	718,912	418,912
Fines and forfeitures	125,000	125,000	78,640	(46,360)
Interest	500,000	500,000	551,780	51,780
Miscellaneous	<u>2,100,000</u>	<u>2,100,000</u>	<u>1,145,488</u>	<u>(954,512)</u>
Total revenues	<u>45,671,791</u>	<u>46,704,510</u>	<u>35,066,076</u>	<u>\$ (11,638,434)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER				
FINANCING USES:				
Current:				
General government	\$ 27,131,014	\$ 30,528,897	\$ 24,481,638	\$ 6,047,259
Public safety	4,647,331	4,556,869	3,903,966	652,903
Public works	10,488,129	8,140,738	5,975,735	2,165,003
Culture and recreation	2,044,257	2,116,946	1,664,948	451,998
Operating transfer to other fund	<u>1,361,060</u>	<u>1,361,060</u>	<u>1,083,991</u>	<u>277,069</u>
Total expenditures, encumbrances and other financing uses	<u>\$ 45,671,791</u>	<u>\$ 46,704,510</u>	<u>\$ 37,110,278</u>	<u>\$ 9,594,232</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (2,044,202)</u>	<u>\$ (2,044,202)</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 35,066,076
Differences-budget to USGAAP:				
Non-budgeted transfer in				102,000
USGAAP adjustments to revenues				<u>1,502,577</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 36,670,653</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 37,110,278
Differences-budget to USGAAP:				
Prior year encumbrances recorded as current year expenditures for USGAAP basis				278,645
Current year encumbrances recorded as expenditures for budgetary basis				(2,753,823)
Non-budgeted expenditures				<u>3,831,691</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 38,466,791</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

NOTES TO THE BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

YEAR ENDED JUNE 30, 2011

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

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

The Municipality prepares its annual budget including the operations of the general fund.

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2011 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2011.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2011

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	\$ 1,011,782
Total U.S. Department of Agriculture			<u>1,011,782</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Community Development Block Grants/Entitlement Grants-Cluster	14.218		2,306,698
Direct Program:			
Urban Development Action Grant	14.221		75,080
Direct Program:			
Emergency Shelter Grants Program	14.231		96,199
Direct Program:			
HOME Investment Partnerships Program	14.239		811,955
Direct Program:			
ARRA-Community Development Block Grant ARRA Entitlement Grant(CDBG-R) (Recovery Act funded)	14.253		4,440

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2011

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT: (CONTINUED)			
Direct Program: ARRA-Homelessness Prevention and Rapid Re-Housing	14.257		206,949
Direct Program: Section 8 Housing Choice Voucher Program	14.871		<u>4,618,351</u>
Total U.S. Department of Housing and Urban Development			<u>8,119,671</u>
U.S. DEPARTMENT OF JUSTICE			
Pass-through the Commonwealth Office of the Governor (CFWM): Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	Not Available	<u>85,586</u>
Total U.S. Department of Justice			<u>85,586</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Direct Program: ARRA-Transit Capital Assistance Grants- Urbanized Area Funding Program	20.509		<u>111,350</u>
Total U.S. Department of Transportation			<u>111,350</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2011

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-through the Commonwealth of Puerto Rico Governor's Office (Elderly Office):			
Special Programs for Aging – Title III, Part B – Grant for Supportive Services and Senior Centers	93.044	Not Available	201,277
Special Programs for Aging – Title III, Part C – Nutrition Services	93.045	Not Available	151,454
Nutrition Services Incentives Program	93.053	Not Available	63,426
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN):			
Community Services Block Grant	93.569	Not Available	35,863
Child Care and Development Block Grant	93.575	Not Available	984,590
Head Start Program	93.600	Not Available	10,354,664
ARRA-Head Start (Recovery Act funded)	93.708		361,021
ARRA-Child Care and Development Block Grant (Recovery Act funded)	93.713	Not Available	163,110
Total U.S. Department of Health and Human Services			<u>12,315,405</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 21,643,795</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2011

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Arecibo** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund 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*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund Head Start, Special Revenue Fund-Other Federal Grants and Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

<u>Description</u>	<u>Special Revenue Fund Head Start</u>	<u>Special Revenue Fund- Other Federal Grants</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Per Schedule of Expenditures of Federal Awards	\$ 11,676,698	\$ 5,348,746	\$ 4,618,351	\$ 21,643,795
Non federal programs expenditures	-	59,036	403,874	462,910
Total expenditures in the basic financial statements	<u>\$ 11,676,698</u>	<u>\$ 5,407,782</u>	<u>\$ 5,022,225</u>	<u>\$ 22,106,705</u>



López-Vega, CPA, PSC

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

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arecibo, 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 March 21, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality of Arecibo's** internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **Municipality of Arecibo's** internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the **Municipality of Arecibo'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 as items **11-02** through **11-03**, to be material weaknesses.

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

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as item **11-01** and **11-04** to be a significant deficiency.

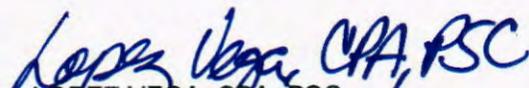
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the **Municipality of Arecibo's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed 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 item **11-02**.

We noted certain other matters that we reported to management of the **Municipality of Arecibo** in a separate letter dated March 21, 2012.

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

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


LOPEZ-VEGA, CPA, PSC

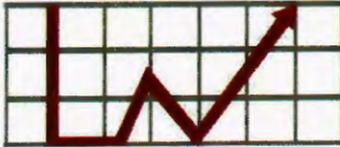
San Juan, Puerto Rico
March 21, 2012

Stamp No. 2575546 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



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INDEPENDENT AUDITOR'S 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

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

Compliance

We have audited the **Municipality of Arecibo's** compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of **Municipality of Arecibo's** major federal programs for the year ended June 30, 2011. The **Municipality of Arecibo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Arecibo's** management. Our responsibility is to express an opinion on the **Municipality of Arecibo's** compliance based on our audit.

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

In our opinion, the **Municipality of Arecibo** 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. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items, **11-05** through **11-14**.

INDEPENDENT AUDITOR'S 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 (CONTINUED)

Internal Control Over Compliance

Management of the **Municipality of Arecibo** is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality of Arecibo's** internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine our 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 **Municipality of Arecibo's** internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items **11-05** through **11-14**. 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.



INDEPENDENT AUDITOR'S 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 (CONTINUED)

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

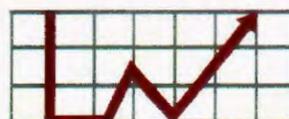
We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Arecibo** in a separate letter dated March 21, 2012.

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

Lopez Vega, CPA, PSC
LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 21, 2012

Stamp No. 2575547 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2011

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued: Unqualified, except for **adverse** for reporting entity.

Internal control over financial reporting:

Material weakness identified? Yes **X** No

Significant deficiencies identified not considered to be material weaknesses? Yes **X** None reported

Noncompliance material to financial statements noted? Yes No **X**

Federal awards

Internal Control over major programs:

Material weakness identified? Yes No **X**

Significant deficiencies identified not considered to be material weaknesses? Yes **X** None reported

Type of auditor’s report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? Yes **X** No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
	CDBG-Entitlement Grants Cluster:
14.218	Community Development Block Grant
14.253	ARRA-Community Development Block Grant (Recovery Act funded)
14.239	Home Investment Partnership Program
14.871	Section 8 Housing Choice Voucher
	CCDF Cluster:
93.575	Child Care & Development Block Grant
93.713	ARRA-Child Care & Development Block Grant
	Head Start Cluster:
93.600	Head Start Program
93.708	ARRA-Head Start

Dollar threshold used to distinguish between Type A and Type B programs \$649,314

Auditee qualified as low-risk auditee? Yes No **X**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference **11-01**

Requirement **Financial Reporting – Accounting Records**

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

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

In addition, The Municipality did not include in the basic financial statements, audited financial information related to the "Corporación de Desarrollo Cultural Teatro Oliver".

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

GASB Statement No. 14 requires that the financial information of component units not be blended with similar financial information of the primary government. Rather, such information should be presented in the basic financial statements of the financial reporting entity.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference **11-01 (Continued)**

Cause of Condition The Municipality was unable to obtain audited financial statements of the “Corporación de Desarrollo Cultural Teatro Oliver”, a Discrete Component Unit.

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

The Municipality is not in compliance with the *GASB Statement No. 14* requirements.

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

Also, we recommend to the Municipality Management to require annual audited financial statements of the “Corporación de Desarrollo Cultural Teatro Oliver”, to the Component Unit management, to include them in the financial reporting entity basic financial statements.

Questioned Costs None

**Management Response
And Corrective Action**

The Municipality concurs with the finding. The Municipality maintains two set of accounting records; a manual system and a computerized system provided in the past by the Municipal Affairs Commissioner Office (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference **11-01 (Continued)**

Nevertheless, as part of the corrective action plan, the Commissioner of Municipal Affairs (“OCAM”) consider alternatives to improve the accounting system, including the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in the near future. Although the Legislature of the Commonwealth of Puerto Rico has appropriated funds for the design and implementation of a new system, no further action has been taken on this matter.

The Municipality will meet the accountant from the “Corporación de Desarrollo Cultural Teatro Oliver” to discuss the manner in which the financial statements of the “Corporación” can be integrated to the financial statements of the Municipality.

Responsible Person: Mr. Guillermo Gabriel- Finance Director

Implementation date: July, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II - Financial Statements Findings

Finding Reference **11-02**

Requirement **Municipal license tax revenues**

Statement of Condition Municipal license tax revenues of the fiscal year 2011-2012, which were collected in advance from taxpayers between January 1 and June 30, 2011 (known in Spanish as "Patente en Suspense"), were used by the Municipality to cover certain operating costs and cash flows shortages of the general fund incurred during the fiscal year ended June 30, 2011. Those unearned revenues collected in advance pertain to the general fund's operating budget of the fiscal year 2011-2012, and could not be used to pay obligations of the prior year. These transactions were not authorized by Municipal Legislature, by Ordinance or Resolution.

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference **11-02 (Continued)**

Questioned Costs None

**Management Response
and Corrective Action**

We expect that with the implementation of corrective actions and the preparation of a cash flows forecasts and projections to anticipate any cash flows shortages and other measurements that our financial consultants can recommend us, avoid the use of the license tax revenues collected in advance, in future fiscal years.

Responsible Person: Mr. Guillermo Gabriel, Finance Director

Implementation Date: During Fiscal Year 2012-2013

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference	11-03
Requirement	Cash Receipts – Revenue, Receivable - Collections
Statement of Condition	<p>We performed a cash receipt test and examined a sample of thirty (30) collections. The following summarize the exceptions noted:</p> <ul style="list-style-type: none">a. In thirty (30) cases, the deposit slip was not available for our examination. This situation caused that the amounts tested could not be traced to the Daily Receipts Validation Report and we could not verify if the collections were deposited in the correct bank account and accounted for in the correct fund and revenue account.b. In thirty (30) cases, the Treasurer did not include adequate evidential documentation (customer’s remittance data as excise tax determination documents, and customer notification letters, etc.) which support the collections receipts CR01 and CR02.c. The Collection Department does not have proper segregation of duties since an Auxiliary Treasurer performs duties of an Official Treasurer.d. In four (4) taxpayer’s file did not include the Municipal License Tax certificate copy.
Criteria	<p>The Section Four (4) of the Chapter three (3) of the Revised Regulation on Basic Standards for Municipalities of Puerto Rico establishes that the Official Treasurer should realize a daily revision of amount collected and amounts credited in bank to assure that the revenues has been duly accounted and processed in the period of collection and in the correct fund.</p>
Cause of Condition	<p>Internal control procedures failed to assure that daily collections are duly accounted for and duly recorded in the correct fund.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II - Financial Statements Findings

Finding Reference 11-03 (Continued)

Effect of Condition In these cases the Municipality did not comply with regulations stated in The Section Four (4) of the Chapter three (3) of the Revised Regulations on Basic Standards for the Municipalities of Puerto Rico.

Recommendation The Municipality should establish adequate monitoring procedures to assure that collections are deposited in the correct bank account and accounted in the correct fund and revenue account. Also, an evaluation of office space and document control should be made to safeguard important documentation about daily transactions and taxpayer's files.

Questioned Costs None

Management Response

And Corrective Action The Municipality concurs with the finding. The Municipality will strengthen its monitoring procedures so that supporting documents are properly filed and available to provide to the auditors.

Responsible Person: Mr. Edgardo Colón - Treasury Department Director

Implementation Date: March, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference	11-04
Requirement	Payroll and Related Liabilities – Personnel, Employment and Rate Authorizations
Statement of Condition	<p>We performed a payroll test and examined a sample of thirty (30) personnel files, and the related payroll documents of those functionaries and employees. The following will summarize the situations found:</p> <p>a. The Municipality has not established a Reclassification and Retribution Plan for regular employees. Also, the plan for functionaries and department directors has not been updated since 1985.</p>
Criteria	<p>Chapter XI Article 11.001 of State Act Number 81 of August 30, 1991 states that each Municipality's should establish an updated Reclassification and Retribution Plan for functionaries and regular employees. Article 11.006 states that all positions are subjected to Reclassification and Retribution Plan, adjusted to circumstances and necessities of the Municipality. The Mayor will establish the plan with the approval of the Municipal Legislature.</p>
Cause of Condition	<p>The Municipality's control and procedures failed to assure that the Municipality establishes a Reclassification and Retribution Plan for regular employees. Also, should update the plan for functionaries and department directors.</p>
Effect of Condition	<p>The Municipality is not in compliance with the Articles 11.001 (b) and 11.006 of State Act Number 81 of August 30, 1991.</p>
Recommendation	<p>We recommend that the Municipality should implement the necessary internal controls and procedures in order to comply with the requirements established in the State Act Number 81 of August 30, 1991.</p>
Questioned Cost	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section II – Financial Statements Findings

Finding Reference **11-04 (Continued)**

**Management Response
and Corrective Action**

The Auditor's recommendation would be considered as part of corrective action plan development and implementation. Also, the Municipality will communicate with "ORHELA" for technical support in the implementation of the plan. We expect that the first phase will be implemented in the fiscal year 2012-2013.

Responsible Person: Mr. Miguel Irizarry- Human Resources and Human Capital Director

Implementation Date: July 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Federal Award Findings and Questioned Costs

Finding Reference	11-05
Program	CDBG Entitlement Grants Cluster: Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development ARRA-Community Development Block Grant ARRA Entitlement Grants (CDBG-R)-(Recovery Act Funded) (CFDA 14.253); U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	During our audit procedures, we examined a sample of twenty one (21) fund requisitions and identified six (6) cases in which the program did not pay its obligations in the time required by Federal Regulations.
Criteria	OMB Common Rules, Subpart C, Section 85.20 (b) (7), requires a cash management system; in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by the grantee.
Cause of Condition	The Federal Program Department did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.
Effect of Condition	The Municipality did not comply with the OMB Common Rules, Subpart C, Section 85.20, (b) (7).
Recommendation	We recommend that management should strengthen it's procedures to minimize the time elapsed between the transfer of funds from the federal agency and the disbursements made by the Municipality.
Questioned Costs	None
Management Response And Corrective Action	Management concurs with the finding. Corrective measures have been taken to prevent the requisition of funds before all documentation has been cleared by the Finance Department.

Responsible Person: Mr. Guillermo Gabriel-Finance Director

Implementation date: Underway

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	11-06
Program	CDBG Entitlement Grants Cluster: Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development ARRA-Community Development Block Grant ARRA Entitlement Grants (CDBG-R)-(Recovery Act Funded) (CFDA 14.253); U.S. Department of Housing and Urban Development
Requirement	Special Test-Required Certifications and HUD Approvals
Statement of Condition	The approved Request for Release of Funds (RROF) for the construction and installation of milestones was not available for examination. The determination of whether HUD has approved the construction project could not be determined.
Criteria	24 CFR Subtitle A, Subpart C, 58.22 states that neither a recipient nor a participant in the development process, may commit HUD assistance on an activity or project until HUD or the state has approved the RROF and the related certification from the responsible entity.
Cause of Condition	The Municipality internal control procedures failed to assure that proper documentation regarding the projects' approval by HUD is obtained for each project.
Effect of Condition	The Municipality is not in compliance with 24 CFR Subtitle A, Subpart C, 58.22.
Recommendation	We recommend management to maintain detailed files documenting the projects RROF approval by HUD, the state or a responsible entity.
Questioned Costs	None
Management Response and Corrective Action	The Municipality Management concurs with the finding. The program staff will be instructed to maintain detailed files documenting the projects RROF approval by HUD, the state or a responsible entity. Responsible Person: Mr. Antonio Montalvo-Municipal Development Director Implementation Date: March, 2012

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **11-07**

Program **CDBG Entitlement Grants Cluster: Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
ARRA-Community Development Block Grant ARRA Entitlement Grants (CDBG-R)-(Recovery Act Funded) (CFDA 14.253); U.S. Department of Housing and Urban Development**

Requirement **Special Test and Provisions- Housing Rehabilitation**

Statement of Condition **During our Housing Rehabilitation test we noted the following exceptions:**

- a. The participant's file did not include a contract of participation between the Municipality and the participant.
- b. In one (1) case, Family composition per eligibility request did not agree with eligibility determination.
- c. In seven (7) participant files Form DM-REH-05B, Initial Evaluation of Housing Unit, was not duly completed. Also, in one (1) file there were no evidence of such Form.
- d. In eight (8) participant files, the Final Determination Form, was not signed by all members of the Committee in charge of approving the donation.
- e. In ten (10) participant files, no evidence of completion of rehabilitation work was found. The Program Coordinator states that due to lack of employees, final inspections are not done in a timely manner.
- f. In one (1) case, funds were used to re-construct a housing unit that was completely consumed by fire. The CDBG Action Plan 2010 in its Housing Reconstruction Program states that this assistance will be used to improve the home with a quick fix, repairing the damaged elements of their units, bringing it as a sound, safe and sanitary dwelling without altering it's original footing. No evidence of Governmental Agencies approval of structure construction, sanitary and electrical permits were found.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **11-07 (Continued)**

Criteria 24 CFR, Section 570.506, states that when CDBG-Entitlement Grants funds are used for rehabilitation, the grantee must assure that the work is properly completed and appropriate documentation is maintained. Also, CFR 24, Section 91.220 and 570.301, states that all activities that a grantee undertakes during their CDBG program year must be identified in an Action Plan or in an amended Action Plan. 2010 Action Plan, in its Housing Rehabilitation Program part states that the rehabilitation activity will assist low income homeowners issuing vouchers for the purchase at authorized hardware stores the construction materials, kitchen cabinets and bathroom fixtures if needed, to improve their home with a quick fix, repairing the damaged elements of their units, bringing it as a sound, safe and sanitary dwelling without altering it's original footing.

Cause of Condition The program developed activities that are not included in the program year Action Plan. Also, the program has not established adequate internal control procedures to assure that rehabilitations are duly completed as required by regulation and appropriate documentation is maintained

Effect of Condition The Municipality is not in compliance with 24 CFR, Section 91.220 and 570.301, and 24 CFR, Section 570.506.

Recommendation We recommend the Program to establish the following procedures:

- a. Ascertain that the deficiencies to be corrected and approved amounts are incorporated into the rehabilitation contract.
- b. Assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contract specifications.
- c. Assure that all participant files include all required documentation duly approved and certified.
- d. Ascertain that the projects developed are included in the program Action Plan or in an amendment to such Plan

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference **11-07 (Continued)**

Questioned Costs None

Management Response

And Corrective Action The Municipality concurs with the finding. Monitoring of files will be pursued in order to assure that all files are completed before requesting payment for the hardware invoice.

Responsible Person: Mr. Guillermo Ruíz- Program Coordinator

Implementation date: June 30, 2012

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Federal Award Findings and Questioned Costs

Finding Reference	11-08
Program	Home Investment Partnership Program (CFDA. No. 14.239); U.S. Department of Housing and Urban Development
Requirement	Activities Allowed or Unallowed
Statement of Condition	<p>The Municipality disbursed \$141,000 in HOME funds to a Community Housing Development Organization (CHDO), for the acquisition of approximately 69 acres of land to develop a 288 unit Housing Project named Bello Monte. The land acquisition included approximately 25 acres of protected wilderness area that needed to be preserved in its natural state and could not be developed. As a result, the Municipality charged the HOME program more than \$52,000 for expenditures that did not meet program objectives and would not generate benefits or expand the supply of decent, safe, sanitary and affordable housing to low and very low income families.</p> <p>b) On July 2009, the Municipality committed in IDIS and awarded the CHDO a second grant totaling more than \$643,000 for the same development. The second grant to the CHDO included \$63,000 for the acquisition of an additional 19 acres of land that had to be preserved in its natural state for mitigation purposes. As of November 2010, no fund has been disbursed for this acquisition.</p>
Criteria	<p>24 CFR, Section 92.205 (a)(2) states that acquisition of vacant land must be undertaken with respect to a particular housing project intended to provide affordable housing.</p>
Cause of Condition	<p>The Municipality disbursed HOME funds for the purchase of land that could not be used to provide housing for low and very low income families.</p>
Effect of Condition	<p>The Municipality is not in compliance with 24 CFR, Section 92.205 (a) (2).</p>
Recommendation	<p>The Municipality should reimburse the HOME program from non-federal funds the \$52,011 charged to its HOME program for ineligible land acquisition. Also, to reprogram and put to better use the \$63,600 in commitments for ineligible land acquisition.</p>
Questioned Costs	\$52,011

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III - Federal Award Findings and Questioned Costs

Finding Reference **11-08 (Continued)**

**Management Response
And Corrective Action**

The Municipality will provide evidence of the reimbursement, as soon the wire transfer is done. To this date a specific date for this transaction is unknown. In order to correct the commitment made to land acquisition for \$63,600, the Municipality states this was an involuntary error made in the Scope of Work in the original contract. The Municipality proceeded to amend the contract and correct this error by stating the \$63,600 as item B. Construction of the Housing units.

The following schedule was approved by HUD on March 5, 2012.

<u>Installment No.</u>	<u>Amount</u>	<u>Date</u>
1	\$13,002.75	March 31, 2012
2	13,002.75	April 30, 2012
3	13,002.75	May 31, 2012
4	13,002.75	June 30, 2012
TOTAL	\$52,011.00	

Responsible Person: Mrs. Sandra Ayala- Program Coordinator

Implementation date: March, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Program Award Findings and Questioned Costs

Finding Reference	11-09
Program	Section 8 Housing Choice Vouchers (CFDA. No. 14.871); U.S. Department of Housing and Urban Development
Requirement	Special Test-Depository Agreements
Statement of Condition	We noted that the Section 8 Housing Choice Voucher Program did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD (Form HUD-51999).
Criteria	24 CFR Subpart D, Section 982.156 states. (c) The PHA must enter into an agreement with the depository in the form required by HUD. (d) If required under a written freeze notice from HUD to the depository: (i) The depository may not permit any withdrawal by the PHA of funds held under the depository unless expressly authorized by written notice from HUD to the depository; and (ii) The depository must permit withdrawals of such funds by HUD. (2) HUD must send the PHA a copy of the freeze notice from HUD to the depository.
Cause of Condition	The Program is not performing an effective review of compliance requirement that are required by HUD.
Effect of Condition	The PHA is not in compliance with laws and established regulation as prescribed by HUD.
Recommendation	Procedures should be implemented to ascertain that the PHA complies with the established Federal Regulation, as prescribed by HUD.
Questioned Costs	None
Management Response	The Municipality management agrees with the finding. The Program Coordinator will make a written request to the bank institution to complete form HUD-51999 as stated in the compliance supplement.

Implementation Date: September, 2011

Responsible Person: Mrs. Enid Martínez-Housing Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	11-10
Program	CCDF Cluster: Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families. ARRA-Child Care and Development Block Grant(CFDA. No. 93.713); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families.
Requirement	Cash Management-Time elapsed
Statement of Condition	We realized Cash Management Test and we found the following exceptions: a. The program funds were not disbursed on a reasonable lapse of time after the transfer of funds.
Criteria	CFR 45, Subpart C, Section 92.20 (b) (7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee.
Cause of Condition	The procedures established by ACUDEN in the delegation of funds agreement do not provide a clause to comply with this requirement.
Effect of Condition	The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to require ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None
Management Response And corrective action	The Municipality management agrees with the finding. The Program Coordinator will make a written request to “ACUDEN” for advice regarding this finding. Responsible Person: Mrs. Ivette Nazario– Program Accountant Implementation date: March, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	11-11
Program	Head Start Cluster: Head Start Cluster;Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families ARRA-Head Start(CFDA. No. 93.708); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families
Requirement	Cash Management-Time elapsed
Statement of Condition	We realized Cash Management Test and we found the following exceptions: a. The program requested funds that were not disbursed on a reasonable lapse of time.
Criteria	CFR 45, Subpart C, Section 92.20 (b) (7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee.
Cause of Condition	The procedures established by ACUDEN in the agreement of delegation of funds do not provide a clause to comply with this requirement.
Effect of Condition	The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (7).
Recommendation	We recommend management to require ACUDEN alternate methods to request cash in order to comply with this requirement.
Questioned Costs	None
Management Response And Corrective Action	The Municipality Management concurs with the finding. Auditor's recommendation would be considered as part of corrective action plan development and implementation. Responsible Person: Mrs. María Torres – Program Accountant Implementation date : March,2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	11-12
Program	Head Start Cluster: Head Start Cluster; Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families ARRA-Head Start(CFDA. No. 93.708); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families
Requirement	Davis-Bacon Act
Statement of Condition	During our Davis-Bacon Act testing procedures over two construction contracts, we noted that the Program did not apply during the contracts period monitoring procedures to assure contractors compliance with payment of prevailing wages rates to employees, as required in the Davis Bacon Act.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.36 (I) (5) with Davis-Bacon Act as amended (40 USC 276A-276A-7)
Cause of Condition	The Program did not have internal controls and procedures to monitor contractor and sub-contractors compliance with Davis Bacon Act.
Effect of Condition	Such condition promoted the Municipality's non-compliance with compliance requirements by CFR 92.36 (I) (5) and with Davis-Bacon Act as amended (40 USC 276A-276A-7).
Recommendation	We recommended the Municipality's management must designate personnel to realize monitoring procedures to in order to monitor contractor and sub-contractors compliance with Davis Bacon Act.
Questioned Costs	None
Management Response and Corrective Action	The Municipality Management will give instructions to designate a program staff as labor standards inspector in future construction or improvements contracts required to be conducted in compliance with Davis Bacon Act. Responsible Persons: Mr. Fernando Seda, Equal Employment Opportunity Officer (EEO), Mrs. María Torres- Program Accountant Implementation date: March, 2012

COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 11-13

Program **Head Start Cluster: Head Start Cluster;Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families**
ARRA-Head Start(CFDA. No. 93.708); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families

Requirement **Matching, Level of Effort, Earmarking - Matching**

Statement of Condition During our matching requirements test, we found the following exceptions:

- a. The Municipality does not maintain proper documentation to ensure the Municipality's compliance with the Head Start Program required contribution.
- b. The value of donated space for In-kind purposes was not determined as per qualifications stated by the Grantor.

In addition, in our sample of two (2) months to evaluate the supporting documents for cash or in-kind local contributions, we noted the following:

- a) There are differences between supporting documents and amounts in the In-kind Monthly Certifications.

Criteria Code of Federal Regulations 45, Subpart C, Section 13.01.20 states that the Municipality is required to contribute at least 20% of cost of the program through cash or in-kind contribution. The grant agreement provision has established that any deficiency in matching share contribution at the end of the program year will be remitted in cash to the grantee in the ninety (90) days after year-end closeout.

Also, 45 CFR, Section 74.23 (cost sharing or matching) states that (a) to be accepted, all cost sharing or matching contributions, including cash and third party in-kind, shall meet all of the following criteria: (1) Are verifiable from the recipient's records; (2) Are not included as contributions for any other federally-assisted project or program; (3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives; (4) Are allowable under the applicable cost principles;

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 11-13 (Continued)

Criteria (5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching; (6) Are provided for in the approved budget; (7) Conform to other provisions of this part, as applicable.

Cause of Condition The Municipality did not maintain proper documentation to verify compliance requirement with matching share contribution.

Effect of Condition The Municipality might not comply with the matching share requirement imposed through grant agreement and program regulations.

Recommendation We recommend management to monitor continuously the level of matching share contribution in order to take appropriate actions, if an anticipated unfavorable outcome will be expected. We also recommend the Program to adopt the necessary measures to ascertain proper documentation to ensure the Municipality's compliance with the matching requirements.

Questioned Costs Not determinable

Management Response

And Corrective Action: To reduce the probability that a similar situation occurs in the future, Management is going to instruct the program accountant to keep all supporting documents and the information gathered from municipal dependencies. Also, the following procedures should be implemented:

- a) In order to report the actual rent in-kind, the Municipality will appraise the donated buildings.
- b) The program will monitor and record monthly entries of the actual local in-kind contributions.
- c) We will request, by writing, to the Municipality's Finance Director, monthly payments of the cash in-kind contribution.

Responsible Person: Mrs. Maria Torres- Program Accountant, Mr. Guillermo Gabriel-Finance Director

Implementation Date: February, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	11-14
Program	Program Head Start Cluster: Head Start Cluster;Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State - Commonwealth of Puerto Rico Administration for Children and Families ARRA-Head Start(CFDA. No. 93.708); U.S. Department of Health and Human Services; Pass through State - Commonwealth of Puerto Rico Administration for Children and Families
Requirement	Procurement and Suspension and Debarment
Statement of Condition	During our contract provisions test, we identified the following conditions: a. Two (2) contracts did not include provisions for granting access to GAO or other federally agency, to books and other documents, etc. b. Two (2) contracts did not include provisions for retention of all required records for three years. c. One (1) contract did not include provisions for Davis Bacon Act. d. One (1) contract did not include provisions for Sections 103 and 107 of the contract Work House & Safety Standards Act. e. One (1) contract did not include provisions for Clean Air and Water Act. f. One (1) contract did not include provisions for Energy Policy and Conservation Act. g. One (1) contract did not include provisions for Copeland 'Anti-kickback'
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.36 (l) (1-13), states that sub-grantee's contract must contain provisions described in paragraph (l) of this section.
Cause of Condition	The Municipality did not maintain appropriate procurement standard procedures in order to assure that a contractor complies with some requirements.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Section 92.36, (l) (1-13).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference **11-14 (Continued)**

Recommendation We recommend management to prepare a sample contract model, which include all contract provisions required by Federal statutes, Executive Orders, and implementing regulations.

Questioned Costs None

**Management Response
and Corrective Action** The Municipality Management will give instructions to prepare a contract model including all contract provisions required by the Federal and State laws and regulations.

Responsible Person: Mrs. Maria Torres- Program Accountant, Mr.
Raymond Guzmán-Municipal Secretary

Implementation Date: February, 2012

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEARS AUDIT FINDINGS

YEAR ENDED JUNE 30, 2011

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
10-06	14.218	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Full corrective action has been taken.</p>
10-07	14.218	<p><u>The bank conciliations from the period of February 2010 through May 2010 were not prepared correctly. The cash balance per conciliation has the same balance from February through June 2010.</u></p> <p>Full corrective action has been taken.</p>
10-08	14.253	<p><u>The bank conciliations from the period of February 2010 through May 2010 were not prepared correctly. The cash balance per conciliation has the same balance from February through June 2010.</u></p> <p>Full corrective action has been taken.</p>
10-09	14.239	<p><u>The bank conciliations from the period of February 2010 through May 2010 were not prepared correctly. The cash balance per conciliation has the same balance from February through June 2010.</u></p> <p>Full corrective action has been taken.</p>
10-10	14.871	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Full corrective action has been taken.</p>
10-11	14.871	<p><u>The bank conciliations from the period of February 2010 through May 2010 were not prepared correctly. The cash balance per conciliation has the same balance from February through June 2010.</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEARS AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		Full corrective action has been taken.
10-12	14.871	<p><u>The Section 8 Housing Choice Voucher Program did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999)</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 11-09.</p>
10-13	93.575	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Full corrective action has been taken.</p>
10-14	93.575	<p><u>The bank conciliations from the period of February 2010 through May 2010 were not prepared correctly. The cash balance per conciliation has the same balance from February through June 2010.</u></p> <p>Full corrective action has been taken.</p>
10-15	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 11-10.</p>
10-16	93.600	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Full corrective action has been taken.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEARS AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
10-17	93.600	<p><u>The bank conciliations from the period of February 2010 through May 2010 were not prepared correctly. The cash balance per conciliation has the same balance from February through June 2010.</u></p> <p>Full corrective action has been taken.</p>
10-18	93.600	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 11-11.</p>
09-05	14.218	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Full corrective action has been taken.</p>
09-07	14.239	<p><u>Management should establish adequate procedures to assure that accounting records balances to commit are in line with the IDIS System in order to correct the differences and to assure that funds are committed and expended in the required period.</u></p> <p>Corrective action was taken.</p>
09-08	14.871	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Corrective action was taken.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO**

SUMMARY SCHEDULE OF PRIOR YEARS AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
09-10	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 11-10.</p>
09-11	93.600	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 11-11.</p>
08-06	14.871	<p><u>Management should improve its internal control and procedures in order to assure that disbursement vouchers, cancelled checks and other supporting documents are available for examination by auditors and includes all required documentation and approvals.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>
08-07	93.575	<p><u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u></p> <p>Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.</p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ARECIBO

SUMMARY SCHEDULE OF PRIOR YEARS AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2011

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
08-09	93.600	<u>Management should require ACUDEN alternate methods to request cash in order to comply with this requirement.</u> Audit finding is no longer valid since has passed more than two (2) years since the reports were submitted to the Single Audit Clearinghouse. The Federal Agency who delegated the funds to the Municipality is not giving follow-up to the finding and has not issued a final decision respect to the finding.