

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, 2012

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditors' Report	1-3
Required Supplementary Information (Part 1) Management's Discussion and Analysis	4-19
Government-Wide Financial Statements:	
Statement of Net Assets	20
Statement of Activities	21
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	22
Statement of Revenues, Expenditures and Changes in Fund Balances	23
Reconciliation of the Balance Sheet- Governmental Funds to Statement of Net Assets	24
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	25
Notes to Basic Financial Statements	26-64
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplementary Information (Part II):	
Budgetary Comparison Schedule-General Fund	65
Notes to Budgetary Comparison Schedule-General Fund	66
Schedule of Expenditures of Federal Awards	67-70
Notes to the Schedule of Federal Awards	71
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	72-73

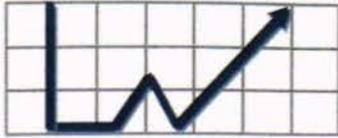
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YEAR ENDED JUNE 30, 2012

CONTENTS

	Page
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u> <u>(CONTINUED)</u>	
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	74-76
<u>FINDINGS AND QUESTIONED COSTS</u>	
Schedule of Findings and Questioned Costs	77-115
Summary Schedule of Prior Years Audit Findings	116-120



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

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
the Municipal Legislature
Municipality of 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, 2012, 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, 2012 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)

As discussed in Note 6 to the basic financial statements, the Municipality did not maintain a proper system of accounting internal controls to provide complete, updated and accurate accounting records for expenditures incurred and unpaid at Balance Sheet date. Accordingly, we were unable to obtain sufficient evidence to test the reasonability and completeness of the amounts recorded as accounts payable amounting to \$4,881,237 in the General Fund in the Balance Sheet at June 30, 2012. Also, certain information to perform the search for unrecorded liabilities as of June 30, 2012 was not provided for our examination. Any adjustment that might result to the balance of accounts payables as of June 30, 2012, will affect the amount of expenditures and expenses recorded on the basic financial statements for the year then ended.

In our opinion, except for the effects of the matter discussed in the fourth paragraph, the financial statements referred to previously present fairly, in all material respects, the financial position of the governmental activities of the primary government of the **Municipality of Arecibo, Puerto Rico**, as of June 30, 2012, 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 July 22, 2013, 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 those 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 **4** through **19** and **65** be presented to supplement the basic financial statements. Such information, although not 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.



INDEPENDENT AUDITORS' REPORT (CONTINUED)

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, as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and are not a required part of the financial statements.

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



LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
July 22, 2013

Stamp No. 2675753 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



This discussion and analysis of the **Municipality of Arecibo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2012. 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, 2011. 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 2012 deserve special mention:

1. The Municipality net assets decreased by \$26,104,748.
2. In the fund financial statements, the governmental activities revenues decreased \$2,953,085 (or 4%) while governmental activities expenditures increased \$14,762,254 (or 21%) in comparison with prior year.
3. The general fund (the primary operating fund) reflected, on a current financial resource basis, a reduction of \$(6,852,986).
4. On a budgetary basis, actual expenditures exceeded actual revenues by \$2,126,641, 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 \$11,894,729.
6. As the end of the current fiscal year the Municipality's General Fund deficit amounted to \$17,784,327, compared to a deficit of \$10,931,341 in the prior fiscal year, as restated.

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

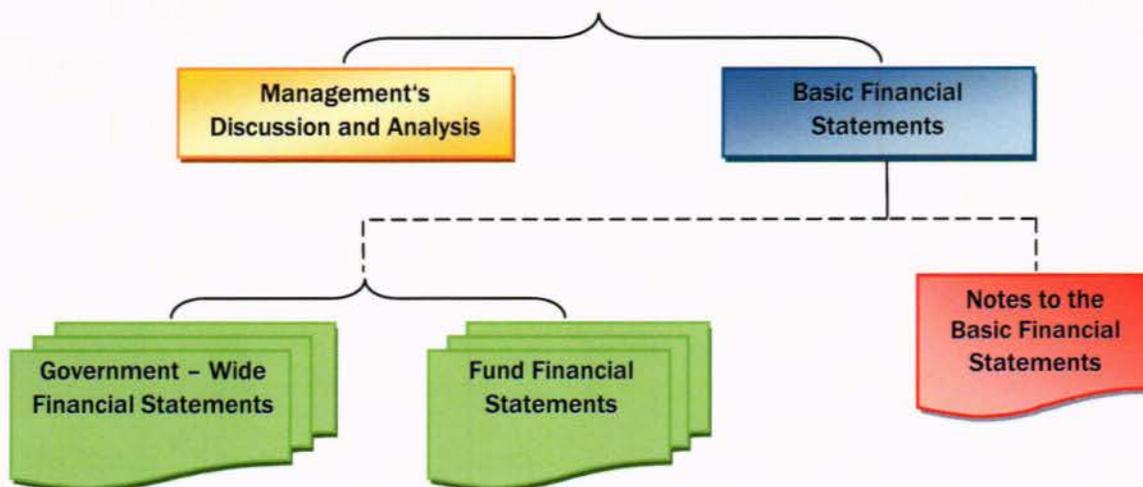
The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2012. The combination of these two perspectives provide the user the opportunity to 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 basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. The basic financial statements include two types of statements that present unique views of the Municipality's financial position. This report also contains required supplementary information (budgetary schedule).

COMPONENTS OF THE ANNUAL FINANCIAL STATEMENTS



FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

Government-Wide Financial Statements

The government-wide financial statements are intended to provide readers with a broad overview of the Municipality's financial position. They are presented using accounting methods very similar to a privately owned business, or the economic resources measurement focus, and full accrual accounting.

- a. The Statement of Net Assets present information on all of the Municipality's assets and liabilities, with the balance between the two reported as Net Assets. Over time, increases or decreases in net assets can serve as an indicator of the Municipality's financial condition.
- b. The Statement of Activities presents information showing how the Municipality's net assets changed during the given fiscal year. In this statement all changes in net assets are reported as soon as the underlying event giving rise to the change occurs regardless of when cash is received or paid. Thus, revenues and expenses are reported in this statement for some items that will only affect cash flows in future fiscal periods.

The government-wide financial statements distinguish functions of the Municipality that are principally supported by Taxes, Capital Grants and Contributions (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges. The governmental activities of the Municipality include general government, public safety, public works, culture and recreation, health and welfare, urban development, claims and losses, education, training and employment, special communities, projects, depreciation and principal plus interest on related long-term debt.

The reader will need to consider non-financial factors, such as changes in the Municipality's property tax base and the condition of the roads, to assess the overall health of the Municipality.

The government-wide financial statements can be found on pages 20 to 21 of this report.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Accordingly, the governmental funds use the modified accrual basis of accounting. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements.

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

Fund Financial Statements (Continued)

The Municipality maintains six (6) individual governmental funds: General Fund, Special Revenue Fund - Head Start, Special Revenue Fund - Other Federal Grants, Capital Projects Fund - State and Local Grants, Debt Service Fund and Other Governmental Funds. Information is shown in the balance sheet and in the statement of revenues, expenditures and changes fund balances.

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

The governmental funds financial statements can be found on pages 22 to 23 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 26 to 64 of this report.

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information. This section includes a budgetary comparison schedule, which includes reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund as presented in the governmental fund financial statements.

The budgetary comparison schedule can be found on the page 65 of this report.

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. Governmental Accounting Standard Board ("GASB 34") requires that these assets be valued and reported within the Governmental column of the Government-Wide Statements.

Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrated its maintenance of locally established levels of service standards, the government

FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

Infrastructure Assets (Continued)

may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

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

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Government-wide Financial Analysis

Assets, liabilities and net assets

Assets

As of June 30, 2012, the Municipality's total assets amounted to \$154,207,738, a reduction of \$2,680,927 when compared with the prior year. The assets exceeded its liabilities by \$40,485,483.

Capital assets include items such as infrastructure, buildings, equipment, machinery, land and other tangible items. Infrastructures include streets, sidewalks, bridges, and others. The Municipality uses capital assets to provide services to the community and thus they are not available for immediate spending. Total capital projects still in process amount to \$12,866,604. During the current fiscal year the Municipality's total capital assets increased by \$3.5 million or 3 percent.

Any resources needed to repay the debt associated with capital assets must be provided from sources other than the capital assets themselves since the capital assets cannot be liquidated to pay the related liabilities.

Liabilities

At the end of fiscal year 2012, total liabilities amounted to \$113,722,255. The current liabilities increased by \$11,945,836 and at the end of the current fiscal year, the Municipality had outstanding debt (bonds and notes) of \$60,380,000. During the current fiscal year, the Municipality's long term liabilities increased by \$11,477,985 or 13 percent due to issuance of new debt.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Net Assets

The Statement of Net Assets serves as an important indicator of the Municipality's financial position at the end of the fiscal year. In the case of the **Municipality of Arecibo**, assets exceed total liabilities by \$40,485,483 at the end of 2012, as compared to prior fiscal year, as restated. The following condensed Statement of Net Assets shows on a comparative basis the most important components of the \$26,104,748 decrease reflected in the Net Assets figure.

Condensed Statement of Net Assets

	2012	2011	Change	%
ASSETS				
Current and other assets	\$ 28,828,404	\$ 35,027,519	\$(6,199,115)	(18)%
Capital assets	125,379,334	121,861,145	3,518,189	3%
Total assets	<u>154,207,738</u>	<u>156,888,664</u>	<u>(2,680,926)</u>	<u>(2)%</u>
LIABILITIES				
Current and other liabilities	23,385,536	11,439,699	11,945,837	104%
Long-term debt outstanding	90,336,719	78,858,734	11,477,985	15%
Total liabilities	<u>113,722,255</u>	<u>90,298,433</u>	<u>23,423,822</u>	<u>26%</u>
NET ASSETS:				
Invested in Capital assets, net of related debt	93,684,334	89,856,145	3,828,189	4%
Restricted	28,599,882	34,680,883	(6,081,001)	(18)%
Unrestricted (deficit)	(81,798,733)	(57,946,797)	(23,851,936)	(41)%
Total net assets: (as restated)	<u>\$ 40,485,483</u>	<u>\$ 66,590,231</u>	<u>(26,104,748)</u>	<u>(39)%</u>

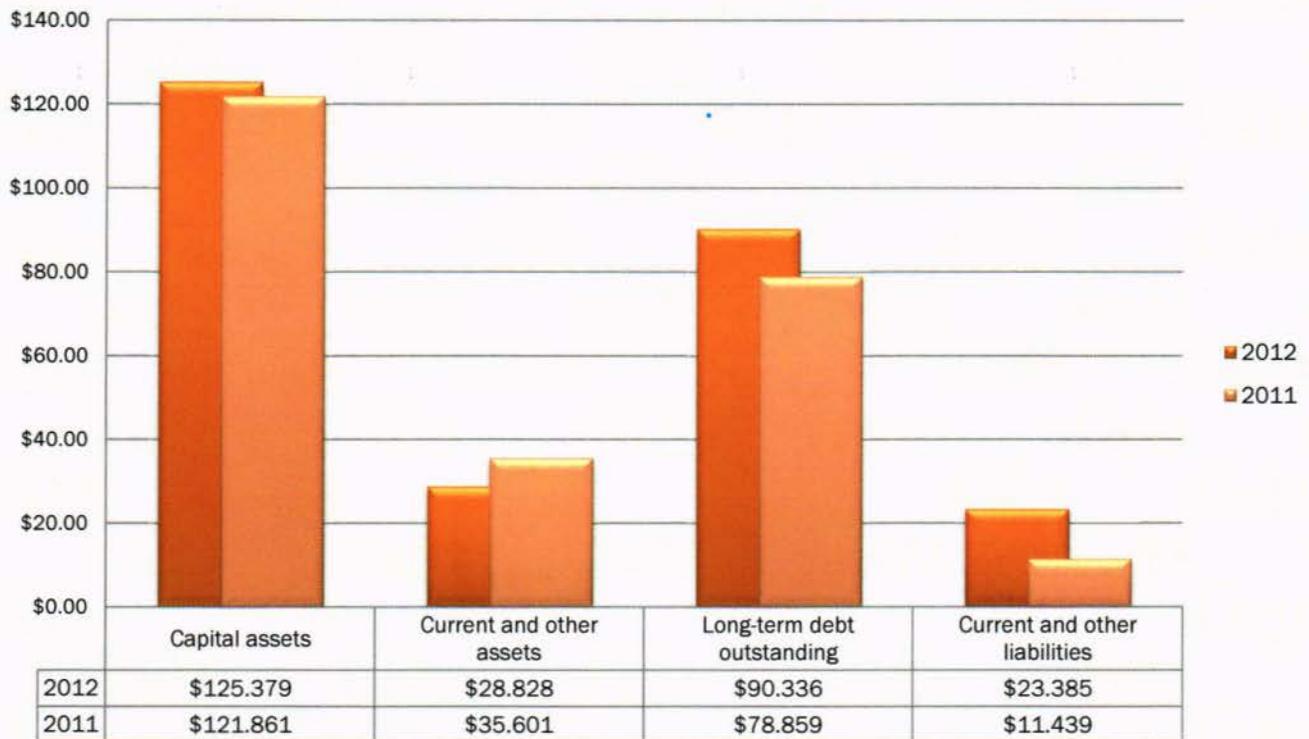
The portion of the Municipality's net assets is the negative unrestricted net assets. The net assets consist of the excess of assets over related liabilities that are neither externally legally restricted, neither invested in capital assets. These negative net assets are the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences, claims and judgments and others. Historically, such obligations have been budgeted, as the Municipality pays, without providing funding for their future liquidation.

An additional portion of the Municipality's net assets represents the investment in capital assets such as land, building, equipment, among others, less any outstanding related debt used to acquire those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although, the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represent another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

The following charts summarize the Municipality's assets and liabilities compared with prior fiscal year.

**Components of Net Assets
(In Millions)**



Changes in Net Assets

The Municipality's net assets decreased by \$26,104,748. Approximately 46% of the Municipality's total revenue came from taxes, while 51% resulted from grants and contributions, including federal aid. Charges for Services provided less than 1%, Interest 1% and others 1.5% of total revenues. The Municipality's largest expenses included items such as general government, health and welfare services and public works. The following table includes the composition of revenues and expenses for the fiscal years ended on June 30, 2012 and 2011.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

CONDENSED STATEMENTS OF ACTIVITIES

	2012	2011	Change	%
Program revenues:				
Charges for services	\$ 201,105	\$ 1,225,748	(1,024,643)	(84)%
Operating grants and contributions	19,680,517	21,825,726	(2,145,209)	(10)%
Capital grants and contributions	2,700,224	2,781,973	(81,749)	(3)%
General revenues:				
Property taxes	16,946,562	18,266,463	(1,319,901)	(7)%
Municipal license tax	7,523,123	7,274,927	248,196	3%
Municipal sales and use tax	3,864,768	3,944,962	(80,194)	(2)%
Grants and contributions not restricted to specific programs	10,479,307	8,843,513	1,635,794	2%
Other local taxes	1,255,238	1,555,196	(299,958)	(19)%
Interest and investment earnings	695,435	552,133	143,302	26%
Net gain on sale of capital asset	436,423	-	436,423	100%
Miscellaneous	785,379	1,232,175	(446,796)	(36)%
Total revenues	64,568,081	67,502,816	(2,934,735)	(4)%
Expenses:				
General government	41,647,408	33,492,638	8,154,770	24%
Public safety	4,611,570	4,073,841	537,729	13%
Public works	14,581,682	7,034,786	7,546,896	107%
Health and welfare	19,804,350	19,135,416	668,934	3%
Culture and recreation	3,992,538	2,470,695	1,521,843	62%
Economic development	217	-	217	100%
Community development	2,749,808	1,925,170	824,638	43%
Urban development	278,653	220,477	58,176	26%
Education	80,111	375,922	(295,811)	(79)%
Interest on long-term debt	2,926,492	2,594,145	332,347	13%
Total expenses	90,672,829	71,323,090	19,349,739	27%
Change in net assets	(26,104,748)	(3,820,274)	(22,284,474)	(583)%
Net assets beginning of year, as restated	66,590,231	70,410,505	(3,820,274)	
Net assets, end of year	\$ 40,485,483	\$ 66,590,231	\$ (26,104,748)	(39)%

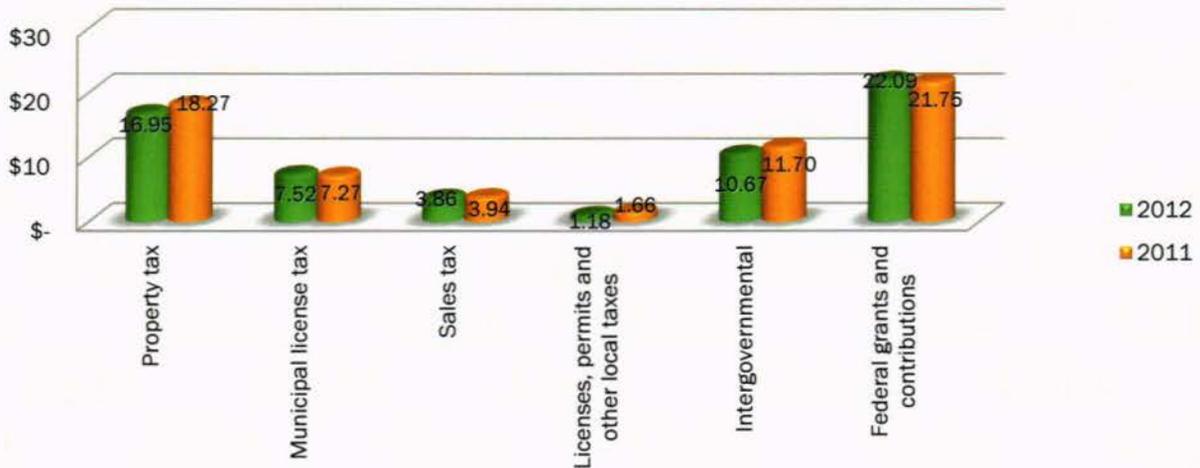
FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

Governmental Funds

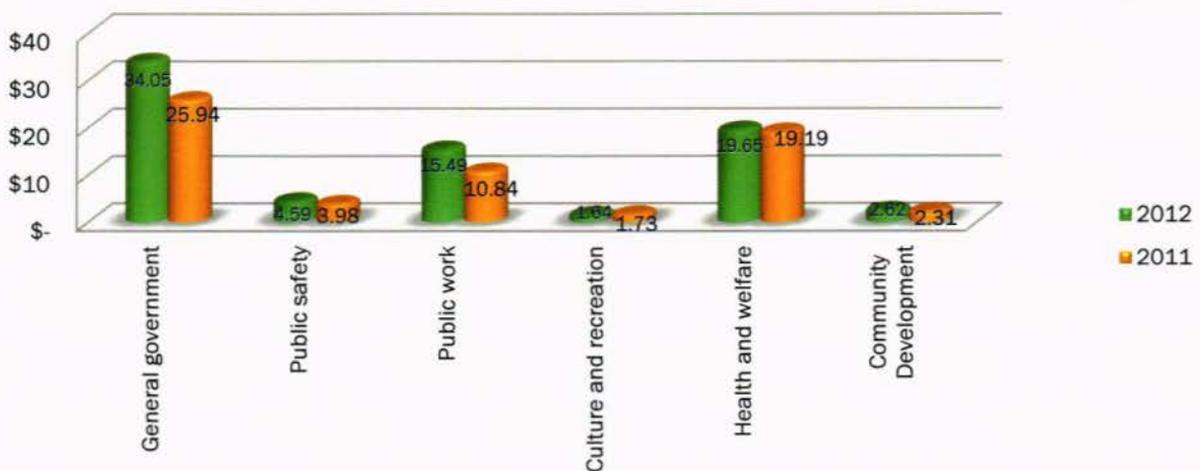
The focus of the Municipality's governmental funds is to provide information on short-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of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

The following chart summarizes the Municipality's major revenues and major expenses compared with prior fiscal year.

Governmental Revenues (In Millions)

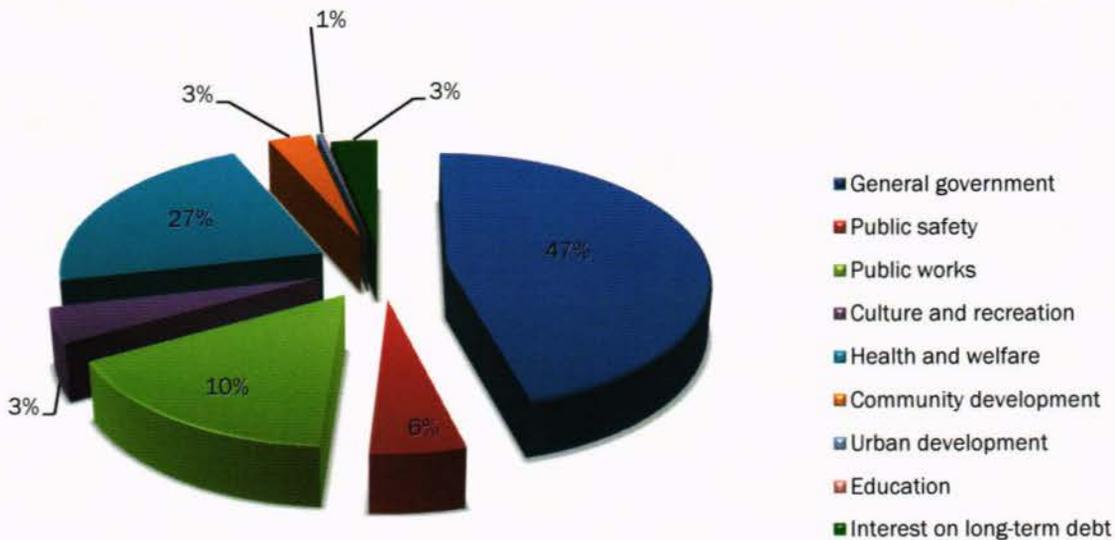
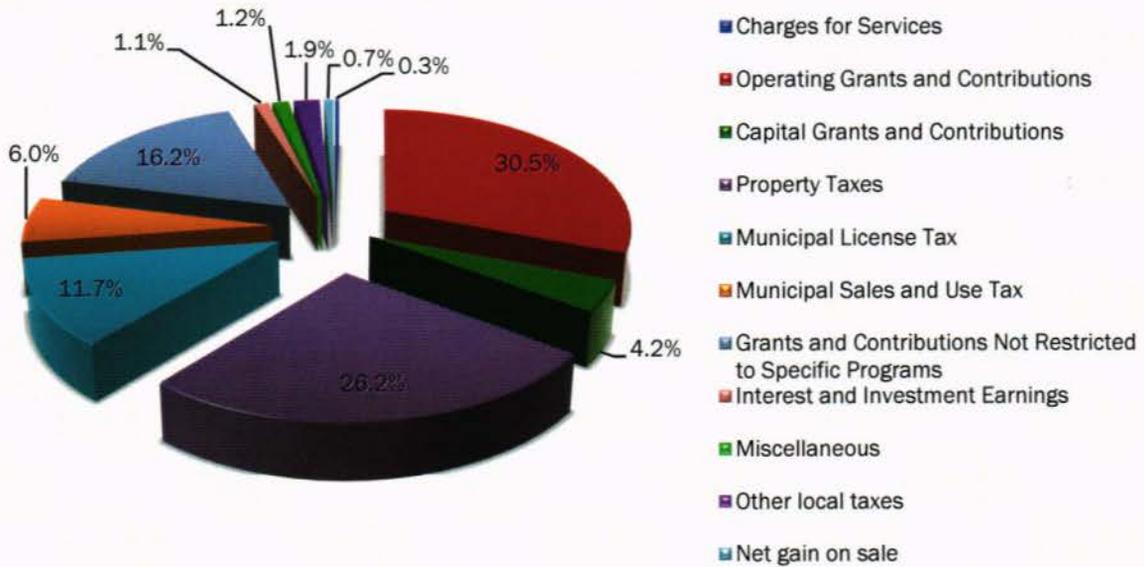


Governmental Expenditures (In Millions)



FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS (CONTINUED)

The following charts summarize the Municipality's revenues and expenses for the fiscal year ended June 30, 2012.



FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS (CONTINUED)

Fund Balances

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$11,894,729, a decrease of \$12 million in comparison with the prior year, as restated. The combined fund balances include restricted fund balances amounting to \$28.65 million. This is the portion of fund balance that reflects resources that are subject to externally enforceable legal restriction 1) to pay for specific program purposes (\$1.4 million); 2) to pay for capital projects (\$17.13 million) and 3) to pay for debt services (\$10.12 million). There are committed fund balances amounting to \$1,988,621 that can only be used pursuant to constraint formally imposed by the Municipal Legislature by ordinances and resolutions. Consequently, since there is an excess of restricted and committed fund balances over total fund balances, a negative unassigned fund balance of \$18.75 million was reported in the governmental funds at June 30, 2012.

Governmental funds include the General Fund, which is the main operating fund of the Municipality. As of June 30, 2012, the General Fund has an accumulated deficit of \$17,784,327 compared with prior fiscal year, as restated, of \$10,931,341. The deficit increased by \$6,852,986.

Property revenues resulted from the approval of Act No. 71 by the Legislature of Puerto Rico, which established an incentive plan for the payment of real and personal property tax dues. This Act provides an amnesty to all property tax payers forgiving all penalties, charges and interest of the unpaid principal of pass-due property tax liability. The period that tax payers have to enjoy for such benefit extends until December 13, 2010. The unpaid property taxes covered

The decrease in construction excise and other local taxes was related with the decrease of investors available to start new construction projects as a result of current recession.

Governmental funds also include the Debt Service Fund. The fund balance of the Debt Service Fund as of June 30, 2012 and 2011 amounted to \$10.12 million and \$9.4 million, respectively.

GENERAL FUND BUDGETARY HIGHLIGHTS

During fiscal year 2011-2012, the Municipal Legislature approved an original budget for the General Fund of \$45,436,947. During the year, there was no amendment to include any changes in revenues that were identified during the course of the fiscal year. The budgetary comparison reflected a deficiency of \$2,126,641 of total current expenses over operating revenues.

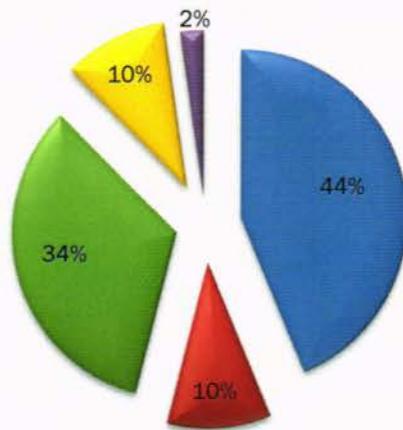
CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2012, amounted to \$171,028,841, which upon deduction of accumulated depreciation in the amount of \$45,649,507; produce a net book value attributable to capital assets in the amount of \$125,379,334. Said investment 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 total increase in the Municipality's investment in capital assets for the current fiscal year represented approximately three percent (3%) of net book value. Depreciation charges for the year totaled \$3,413,176.

The following chart summarizes the Municipality's capital assets for the fiscal years ended June 30, 2012 and 2011.

Capital Assets (Net of accumulated depreciation)		
	Governmental Activities	
	2012	2011
Land and improvements	\$ 54,782,094	\$ 54,696,105
Construction in progress	12,866,604	8,842,087
Buildings and buildings improvements	42,032,732	42,867,982
Infrastructure and infrastructure improvements	12,824,795	13,050,178
Machinery and equipment	2,873,109	2,404,793
Total	\$ 125,379,334	\$ 121,861,145



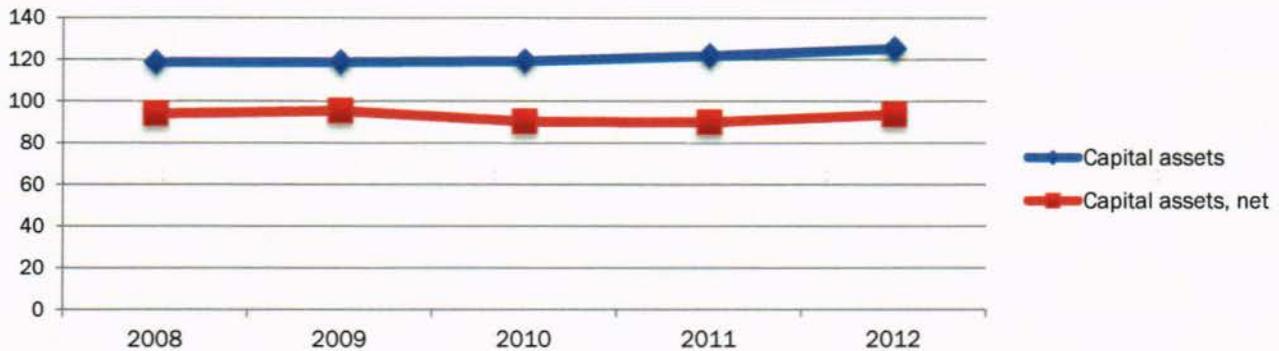
Capital Assets 2012

- Land and land improvements
- Construction in progress
- Buildings and buildings improvements
- Infrastructure and infrastructure improvements
- Machinery and equipment

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

Capital Assets (Continued)

The following chart provides information about the behavior of the Municipal's Capital Assets during past five years.



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, 2012, the Municipality has \$8,194,736 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.

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

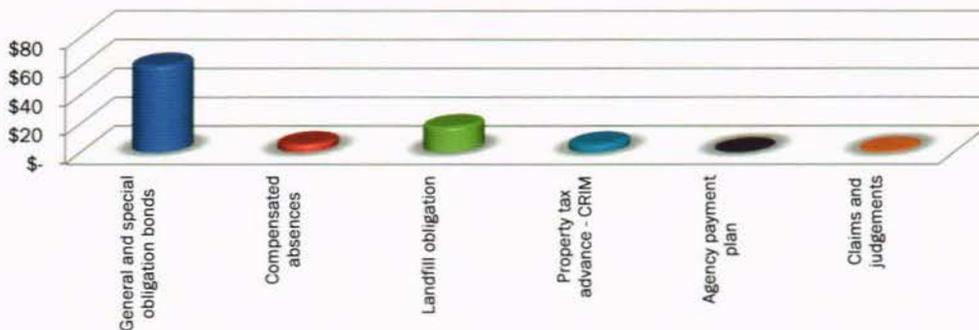
Debt Administration (Continued)

On June 30, 2012, the Municipality had \$90.33 million in bonds, notes and other long-term debts outstanding, as compared to \$78.85 million in prior year, an increase of \$11.48 million, as shown in table below. The Municipality paid \$3.2 million in principal and \$2.7 million in interest on that debt during the year. During the fiscal period, the Municipality issued bonds through the Government Development Bank for Puerto Rico in the amount of \$7.84 million; \$5.775 million in operational loan and \$2.06 for payment of debt with the Retirement System Administration. Under current state statutes, the Municipality required to limit the amount of general obligation debt to 10% of the total assessment of property located within the Municipality, for bonds to be repaid with the proceeds of property tax restricted for debt services.

The following chart summarizes the Municipality's long term debt for the fiscal years ended June 30, 2012 and 2011.

Long Term Debt		
	Governmental Activities	
	2012	2011
General and special obligation	\$ 60,380,000	\$55,739,000
Compensated absences	5,684,383	5,121,063
Landfill obligation	17,864,264	8,174,679
Advances from CRIM	5,601,531	4,323,720
Payment plans with agencies and suppliers	-	5,213,351
Other obligations	806,541	286,921
Total	\$ 90,336,719	\$ 78,858,734

Long Term Debt 2012

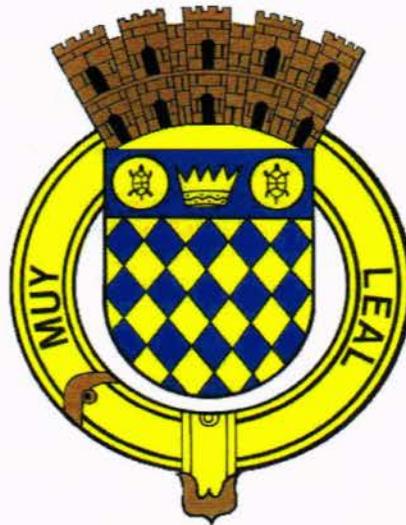


COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARECIBO

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

Year Ended June 30, 2012



Municipality of Arecibo, P.O. Box 1086, Arecibo, Puerto Rico 00613

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

Debt Administration (Continued)

At June 30, 2012, the Municipality had \$52.79 million of general obligation bonds outstanding. The following chart indicates the principal amortization of the Municipality's general obligation bonds in five-year increments.

General Obligation Bonds Principal Amortization In five Year Increments Following Fiscal Year 2012	
<u>Range of Years</u>	<u>Principal Amortization</u>
2013-2017	\$ 15,503,000
2018-2022	15,589,000
2023-2027	12,499,000
2028-2032	5,365,000
2033-2037	3,830,000
Total	\$ 52,786,000

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 2012-2013.

FINAL COMMENTS

On August, 22, 2012, the Municipal Legislature approved the issuance of a general obligation bond for the amount of \$505,000, for cash flow deficiencies. Repayment of the bond is scheduled from July 2013 through July, 2037.

On January 29, 2013, the Municipal Legislature approved an increase in tax rates for real and personal property. The Additional Special Contribution tax rate will increase from (2.75%) to three point five percent (3.50%) for real and personal property. The new tax rates will apply on January 1, 2013, and on July 1, 2013 the CRIM will begin its billing and collection.

On January 29, 2013, the Municipal Legislature authorized the Mayor to use \$2,000,000 from Government of Puerto Rico Legislature's Joint Resolution 243-2012, for operational and administrative expenditures. The original amount of the Resolution was \$3,000,000 for payment of employees' salaries and Christmas bonuses.

FINAL COMMENTS (CONTINUED)

In Ordinances 28 and 37, approved by the Municipal Legislature on January 15 and January 29, 2013, respectively, the legislative body authorized the Mayor to establish financial and administrative policies due to fiscal emergency. These Ordinances establish policies of personnel management, awarding of existent and future contracts, equipment acquisition, determining and collecting accounts receivable, legislative body expenditures, use of municipal vehicles, waste management, land disposition, use of facilities fees, sale of advertisement spots, service fees, and joint ventures with other government agencies and municipalities to provide services.

On April 9, 2013, the Municipal Legislature approved an amnesty for the payment of one percent (1%) from the sale and use tax applicable to the Municipality. Law 117-2006 established the applicability of a uniform rate of 1.5% of sales and use tax for the municipalities of Puerto Rico. One percent will be collected by the Municipality and 0.5 by Government of Puerto Rico's Department of Treasury. It is over this one percent that this amnesty was approved. The amnesty will be in effect from April 9, 2013 through June 28, 2013.

On April 9, 2013, the Municipal Legislature approved an amnesty for the payment of interests and penalties on taxpayers' municipal license taxes debts. Mainly, the amnesty is for debts of more than five (5) years. An interest rate of 5% over the amount due will be the only charge applied. The amnesty will be in effect from April 9, 2013 through June 30, 2013.

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, 2012**

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 8,428,078
Cash with fiscal agent	18,390,927
Accounts receivable:	
Municipal sales tax	277,436
Intergovernmental	79,617
Federal grants	743,196
Note receivable	909,150
Capital assets	
Land, improvements, and construction in progress	67,668,698
Other capital assets, net of depreciation	57,710,636
Total capital assets	125,379,334
Total assets	154,207,738
Liabilities	
Accounts payable and accrued liabilities	12,882,476
Bank overdraft	1,503,598
Due to other governmental entities	1,320,817
Deferred revenues:	
Municipal license tax	5,284,541
Federal grant revenues	1,162,732
Interest payable	1,231,372
Noncurrent liabilities:	
Due within one year	8,190,573
Due in more than one year	82,146,146
Total liabilities	113,722,255
Net Assets	
Invested in capital assets, net of related debt	93,684,334
Restricted for:	
Capital projects	18,260,958
Debt service	8,892,238
Other purposes	1,446,686
Unrestricted (deficit)	(81,798,733)
Total net assets	\$ 40,485,483

**Commonwealth of Puerto Rico
Municipality of Arecibo
Statement of Activities
For the Year Ended June 30, 2012**

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and
		Charges for	Operating	Capital	Changes in Net Assets
		Services	Grants and	Grants and	Governmental
			Contributions	Contributions	Activities
General government	\$41,647,408	\$ 192,027	\$ -	\$ -	\$ (41,455,381)
Public safety	4,611,570		260,694		(4,350,876)
Public works	14,581,682		261,406	96,682	(14,223,594)
Health and welfare	19,804,350		19,117,672		(686,678)
Culture and recreation	3,992,538	9,078			(3,983,460)
Economic development	217				(217)
Community development	2,749,808			2,603,542	(146,266)
Urban development	278,653		40,745		(237,908)
Education	80,111				(80,111)
Interest on long-term debt	2,926,492				(2,926,492)
Total governmental activities	\$90,672,829	\$ 201,105	\$19,680,517	\$ 2,700,224	(68,090,983)

General revenues:

Property taxes	16,946,562
Municipal license tax	7,523,123
Municipal sales tax	3,864,768
Other local taxes	1,255,238
Grants and contributions not restricted to specific programs	10,479,307
Interest and investment earnings	695,435
Net gain on sale of capital asset	436,423
Miscellaneous	785,379
Total general revenues	41,986,235
Change in net assets	(26,104,748)
Net assets - beginning, as restated	66,590,231
Net assets - ending	\$ 40,485,483

Commonwealth of Puerto Rico
Municipality of Arecibo
Balance Sheet
Governmental Funds
June 30, 2012

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets						
Cash and cash equivalents	\$ -	\$ 418,513	\$ 5,533,145	\$ -	\$ 2,476,420	\$ 8,428,078
Cash with fiscal agent	152,198		8,194,736	10,043,993		18,390,927
Accounts receivable:						
Municipal sales tax	277,436					277,436
Intergovernmental				79,617		79,617
Federal grants					743,196	743,196
Due from other funds	1,029,250	193,180	4,899,780		22,500	6,144,710
Total assets	<u>\$ 1,458,884</u>	<u>\$ 611,693</u>	<u>\$ 18,627,661</u>	<u>\$ 10,123,610</u>	<u>\$ 3,242,116</u>	<u>\$ 34,063,964</u>
Liabilities and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 6,238,750	\$ 81,667	\$ 29,358	\$ -	\$ 403,062	\$ 6,752,837
Bank overdraft	1,503,598					1,503,598
Due to other governmental entities	1,320,817					1,320,817
Due to other funds	4,895,505		337,345		911,860	6,144,710
Deferred revenues:						
Municipal license tax	5,284,541					5,284,541
Federal grant revenues		530,026			632,706	1,162,732
Total liabilities	<u>19,243,211</u>	<u>611,693</u>	<u>366,703</u>	<u>-</u>	<u>1,947,628</u>	<u>22,169,235</u>
Fund balances:						
Restricted	152,198		17,135,434	10,123,610	1,248,698	28,659,940
Committed			1,338,707		649,914	1,988,621
Unassigned	(17,936,525)		(213,183)		(604,124)	(18,753,832)
Total fund balances	<u>(17,784,327)</u>	<u>-</u>	<u>18,260,958</u>	<u>10,123,610</u>	<u>1,294,488</u>	<u>11,894,729</u>
Total liabilities and fund balances	<u>\$ 1,458,884</u>	<u>\$ 611,693</u>	<u>\$ 18,627,661</u>	<u>\$ 10,123,610</u>	<u>\$ 3,242,116</u>	<u>\$ 34,063,964</u>

Commonwealth of Puerto Rico
Municipality of Arcibo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2012

	General Fund	Special Revenue Fund Head Start	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 11,935,221	\$ -	\$ -	\$ 5,011,340	\$ -	\$ 16,946,561
Municipal license taxes	7,523,123					7,523,123
Municipal sales taxes	3,011,440			853,328		3,864,768
Licenses, permits and other local taxes	1,183,112					1,183,112
Charges for services	199,055				2,050	201,105
Intergovernmental	10,479,307		155,282		38,845	10,673,434
Fines and forfeitures	72,127					72,127
Rent of property	178,695		96,683			275,378
Interest	695,435					695,435
Federal grants		11,129,536			10,960,395	22,089,931
Miscellaneous	1,024,757					1,024,757
Total revenues	36,302,272	11,129,536	251,965	5,864,668	11,001,290	64,549,731
Expenditures						
Current:						
General government	34,052,999					34,052,999
Public safety	4,339,391				251,649	4,591,040
Public works	10,320,771		5,177,515			15,498,286
Health and welfare		11,247,666			8,410,248	19,657,914
Culture and recreation	1,606,425		37,188			1,643,613
Community development					2,619,742	2,619,742
Urban development			276,089		2,564	278,653
Education					75,029	75,029
Debt service:						
Principal				3,199,000		3,199,000
Interest				2,743,444		2,743,444
Total expenditures	50,319,586	11,247,666	5,490,792	5,942,444	11,359,232	84,359,720
Excess (deficiency) of revenues over (under) expenditures	(14,017,314)	(118,130)	(5,238,827)	(77,776)	(357,942)	(19,809,989)
Other financing sources (uses)						
Transfers in	894,482	522,344		1,076,006	23,940	2,516,772
Transfers out	(1,570,154)	(404,214)		(300,000)	(242,404)	(2,516,772)
Long-term debt issued	7,840,000					7,840,000
Total other financing sources (uses)	7,164,328	118,130	-	776,006	(218,464)	7,840,000
Net change in fund balances	(6,852,986)	-	(5,238,827)	698,230	(576,406)	(11,969,989)
Fund balance, beginning as restated	(10,931,341)	-	23,499,785	9,425,380	1,870,894	23,864,718
Fund balance, ending	\$ (17,784,327)	\$ -	\$ 18,260,958	\$ 10,123,610	\$ 1,294,488	\$ 11,894,729

*Ok
 01/08/2013*

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, 2012

Total Fund Balances - Governmental Funds \$ 11,894,729

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	\$ 67,668,698	
Depreciable Capital Assets, net of depreciation	<u>57,710,636</u>	
Total Capital Assets		125,379,334

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

Notes receivable		909,150
------------------	--	---------

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	60,380,000	
Construction in progress accounts payables	6,129,639	
Landfill obligation	17,864,264	
Property taxes debt	5,601,531	
Compensated absences	5,684,383	
Interest payable	1,231,372	
Department of Labor Debt	115,619	
Claims and judgment	<u>690,922</u>	
Total Long-Term Liabilities		<u>(97,697,730)</u>

Total Net Assets of Governmental Activities \$ 40,485,483

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, 2012

Net Change in Fund Balances - Total Governmental Funds \$ (11,969,989)

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. 6,945,757

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. (14,392)

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. (3,413,176)

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. (183,048)

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. (5,991,915)

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. (3,061,732)

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. 5,914,332

Change in Landfill Accrual (9,689,585)

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. (4,641,000)

Change in Net Assets of Governmental Activities \$ (26,104,748)

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.

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 fiscal year ended June 30, 2011, 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.

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:

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.

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.

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

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,

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, 2012. Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues.

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, 2012. At June 30, 2012, 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.

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, 2012.

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."

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

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, 2012 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.

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

E. Assets, liabilities and net assets (Continued)

- 9. Fund Balances**– In fiscal year 2011, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy upon the use of the resources reported in governmental funds.

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

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

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, 2012.

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.

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 define 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.

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, 2012 to \$999,178. 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, 2012 amounted to \$984,278.

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.

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, 2012.

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, 2012, (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, 2012, 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, 2012, 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, 2012. Therefore, the Municipality's management has concluded that at June 30, 2012 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, 2012.

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 \$418,513, \$5,533,145, and \$2,476,420 in the special revenue fund-Head Start, capital projects fund-local and state grant, and in other governmental funds, respectively, were fully collateralized at June 30, 2012.

2. CASH AND CASH EQUIVALENTS (CONTINUED)

The deposits at GDB of \$152,198 in the general fund, the \$8,194,736 that are restricted principally for capital projects in the capital project fund – local and state grant, and the \$10,043,993 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 \$3,011,440 during the year ended June 30, 2012. Also, \$853,328 from the Municipal Redemption Fund are included in the debt service fund. Municipal sales and use tax receivable of \$277,436, in the general fund represents filed tax returns that were uncollected as of June 30, 2012, 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”)	\$ 79,617
Total	<u>\$ 79,617</u>

3. RECEIVABLES (CONTINUED)

C. **Federal grants**-Federal grants receivable in the other governmental funds 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	\$ 282,939
Home Program	54,034
Public Assistance Grant	20,268
Child Care Development Block Grant Program	57,355
ARRA-Emergency Shelter Grant (HPRP)	30,438
Homeland Security Grant Program	275,021
Others	<u>23,141</u>
Total	<u>\$ 743,196</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 the fiscal year 2008-2009, the buyer paid \$1,940,850. The remaining receivable as of June 30, 2012 amounts to \$909,150.

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4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2012, and interfund transfers during the fiscal year ended at June 30, 2012, 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	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	\$ 275,706
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	416,199
Special Revenue Fund-Head Start Fund	General Fund	Reimbursable Expenditures	193,180
General Fund	Capital Projects Funds	Reimbursable Expenditures	337,345
Capital Projects Fund	Other Governmental Funds	Reimbursable Expenditures	219,955
Other Governmental Funds	General Fund	Reimbursable Expenditures	22,500
Capital Projects Fund	General Fund	Reimbursable transfer of funds	<u>4,679,825</u>
Total			<u>\$ 6,144,710</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	\$ 1,076,006
General Fund	Special Revenue Fund-Head Start Fund	In-kind Cash Contribution	470,208
Other Governmental Funds	General Fund	Reimbursement of funds	190,268
Other Governmental Funds	Special Revenue Fund-Head Start Fund	Reimbursement of funds	52,136
General Fund	Other Governmental Funds	Transfer of funds for special purpose	23,940
Special Revenue Fund-Head Start Fund	General Fund	Reimbursement of funds	404,214
Debt Service Fund	General Fund	Transfer of funds for operational expenditures	<u>300,000</u>
Total			<u>\$ 2,516,772</u>

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 2012, 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, 2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2012</u>
Capital asset, not being depreciated:				
Construction in progress	\$ 8,842,087	\$ 4,723,976	\$ (679,459)	\$ 12,866,604
Land	54,696,105	103,866	(17,877)	54,782,094
Total capital assets not being depreciated	<u>63,538,192</u>	<u>4,827,842</u>	<u>(697,336)</u>	<u>67,668,698</u>
Capital assets, being depreciated:				
Buildings	45,914,666	550,081	-	46,464,747
Buildings improvements	11,799,471	67,798	-	11,867,269
Infrastructure	16,957,618	59,499	-	17,017,117
Infrastructure improvements	8,940,607	508,221	-	9,448,828
Equipment	5,022,486	570,214	(42,450)	5,550,250
Furnishing	1,804,872	9,871	(28,698)	1,786,045
Computers	1,054,047	15,743	(77,898)	991,892
Works of Art	157,261	-	-	157,261
Vehicles	9,059,675	1,033,824	(16,765)	10,076,734
Total capital assets being depreciated	<u>100,710,703</u>	<u>2,815,251</u>	<u>(165,811)</u>	<u>103,360,143</u>
Less accumulated depreciation for:				
Buildings	(13,143,129)	(1,158,445)	-	(14,301,574)
Buildings improvements	(1,703,026)	(294,684)	-	(1,997,710)
Infrastructure	(10,997,590)	(174,050)	-	(11,171,640)
Infrastructure improvements	(1,850,457)	(619,053)	-	(2,469,510)
Equipment	(4,050,058)	(421,809)	37,904	(4,433,963)
Furnishing	(1,652,172)	(52,257)	22,476	(1,681,953)
Computers	(847,929)	(147,886)	74,274	(921,541)
Work of Art	(143,135)	(2,097)	-	(145,232)
Vehicles	(8,000,254)	(542,895)	16,765	(8,526,384)
Total accumulated depreciation	<u>(42,387,750)</u>	<u>(3,413,176)</u>	<u>151,419</u>	<u>(45,649,507)</u>
Total capital assets being depreciated, net	<u>58,322,953</u>	<u>(597,925)</u>	<u>(14,392)</u>	<u>57,710,636</u>
Governmental activities capital assets, net	<u>\$121,861,145</u>	<u>\$ 4,229,917</u>	<u>\$ (711,728)</u>	<u>\$125,379,334</u>

5. CAPITAL ASSETS (CONTINUED)

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

Governmental activities:

General Government	\$ 647,562
Public Safety	235,076
Public Works	1,008,391
Health and Welfare	17,616
Culture and Recreation	890,717
Economic Development	361
Community Development	608,371
Education	<u>5,082</u>

Total depreciation expense-governmental activities \$ 3,413,176

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2012 are summarized as follows:

<u>Description</u>	<u>General Fund</u>	<u>Special Revenue Fund - Head Start</u>	<u>Capital Projects Fund - State & Local Grants</u>	<u>Debt Service Fund</u>	<u>Other Governmental Fund</u>	<u>Total</u>
Accounts payable	\$ 4,881,237	\$ 81,667	\$ 29,358	\$ -	\$ 403,062	\$ 5,395,324
Accrued liabilities	<u>1,357,513</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,357,513</u>
Total	<u>\$ 6,238,750</u>	<u>\$ 81,667</u>	<u>\$ 29,358</u>	<u>\$ -</u>	<u>\$ 403,062</u>	<u>\$ 6,752,837</u>

The Municipality did not maintain a proper system of accounting internal controls to provide complete, updated and accurate accounting records for expenditures incurred and unpaid at the Balance Sheet date. Accordingly, we were unable to obtain sufficient evidence to test the reasonability and completeness of the amounts recorded as accounts payable amounting to \$4,881,237 in the General Fund in the Balance Sheet at June 30, 2012.

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	\$ 275
Treasury Department	437,424
Puerto Rico Aqueduct and Sewer Authority	<u>883,118</u>
Total	<u>\$ 1,320,817</u>

8. DEFERRED REVENUES

- A. Municipal License Tax-** The deferred revenues of \$5,284,541 in the general fund relates to municipal license tax collected in fiscal year 2011-12 that will be earned in fiscal year 2012-13.
- 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	\$ 158,653
Head Start Program	371,370
ARRA-Head Start Program	<u>3</u>
Total	\$ 530,026

The deferred revenues presented in other governmental funds 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	86,216
Special Program for Aging – Title III	23,285
Family Self Sufficiency	16,574
Public Assistance Grant	224,365
ARRA-Energy Conservation and Efficiency	56,866
Others	<u>63,400</u>
Total	\$ 632,706

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.

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, 2012, the CRIM issued the final settlement noting that advances exceeded collections by \$1,347,602. This balance will be retained by the CRIM during fiscal year 2013-2014. Also, the Municipality owes \$2,285,407 from June 30, 2011 final settlement. 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.

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 \$1,091,562 and \$876,962 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 9.58% for real property and 7.58% 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) 2.75% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2012, 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	\$53,686,000	\$ 2,065,000	\$ (2,965,000)	\$ 52,786,000	\$ 2,636,000
Notes Payable	2,053,000	5,775,000	(234,000)	7,594,000	905,000
LIMS Repayment Plan	106,566		(106,566)		
Property Tax Debt - Law 42	1,117,503		(25,941)	1,091,562	27,571
Property Tax Debt - Law 146	920,810		(43,849)	876,961	43,848
CRIM Final Liquidation 2011-2012		1,347,602		1,347,602	
CRIM Final Liquidation 2010-2011	2,285,407			2,285,407	2,285,407
Compensated Absences	5,121,063	1,064,994	(501,675)	5,684,382	1,745,000
Landfill Obligation	8,174,679	9,689,585		17,864,264	
Retirement System Administration Payment Plan	2,535,418		(2,535,418)		
PR Aqueduct and Sewer Authority- Payment Plan	666,569		(666,569)		
Waste Disposal Contract Debt	1,886,186		(1,886,186)		
Department of Labor Debt	125,178	115,619	(125,178)	115,619	31,825
Claims and Judgments	180,355	533,517	(22,950)	690,922	515,922
Total	\$78,858,734	\$20,591,317	\$ (9,113,332)	\$90,336,719	\$ 8,190,573

- 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, 2012 are as follows:

<u>Description</u>	<u>Balance at June 30, 2012</u>
2010 General obligation bond for operational expenditures 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%.	\$ 750,000
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%.	75,000
2010 General obligation bond for operational expenditures 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%.	1,290,000
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%.	181,000

10. LONG-TERM LIABILITIES (CONTINUED)

Description	Balance at June 30, 2012
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%.	8,770,000
1998 General obligation bond for operational expenditures 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%.	547,000
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%.	5,370,000
2002 Special obligation bond for operational expenditures 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%.	8,150,000
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%.	3,990,000
2003 Special obligation bond for operational expenditures 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%.	3,355,000
2004 General Obligation bond for operational expenditures 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%.	90,000
2004 General obligation bond for operational expenditures 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%.	500,000
2004 Special obligation bond for operational expenditures 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%.	36,000
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%.	250,000
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%.	1,305,000
2005 General obligation bond for operational expenditures 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%.	2,710,000
2007 General obligation bond for operational expenditures 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%.	617,000
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%.	975,000
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%.	3,825,000

10. LONG-TERM LIABILITIES (CONTINUED)

Description	Balance at June 30, 2012
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%.	1,790,000
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%.	4,075,000
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%.	2,070,000
2011 Special obligation bond for payment of operational expenditures with an original amount of \$2,065,000 due in installments of \$25,000 to \$170,000 through July 1, 2036, with interest ranging from 6.00% to 7.50%.	2,065,000
Total	<u>\$ 52,786,000</u>

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, the Series 2010 amounting to \$4,140,000 and \$2,095,000, and the Series 2011 amounting to \$2,065,000 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>
2013	2,636,000	2,367,703
2014	3,833,000	3,241,367
2015	3,449,000	3,034,484
2016	2,691,000	2,844,214
2017	2,894,000	2,667,147
2018-2022	15,589,000	10,344,271
2023-2027	12,499,000	5,627,640
2028-2032	5,365,000	2,349,400
2033-2037	<u>3,830,000</u>	<u>535,662</u>
Total	<u>\$ 52,786,000</u>	<u>\$ 33,011,888</u>

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, 2012</u>
2011 Series	7-01-18	\$ 825,000	6% to 7.50%	\$ 730,000
2011 Series	7-01-18	1,228,000	6% to 7.50%	1,089,000
2012 Series	7-01-19	5,775,000	6% to 7.50%	<u>5,775,000</u>
Total notes payable				<u>\$ 7,594,000</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>
2013	905,000	416,338
2014	976,000	462,728
2015	1,049,000	389,137
2016	1,127,000	307,500
2017	1,216,000	219,675
2018-2022	<u>2,231,000</u>	<u>163,162</u>
Total	<u>\$ 7,594,000</u>	<u>\$ 1,958,540</u>

- 4. Property Tax Debt-** These amounts represent the balance owed to the Municipal Revenue Collection Center (CRIM) at June 30, 2012, as described in Note 9.
- 5. Compensated Absences-** The government-wide statement of net assets includes \$2,946,316 of accrued sick leave benefits, and \$2,738,066 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

10. LONG-TERM LIABILITIES (CONTINUED)

6. **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 2011-2012, 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 \$17,864,264 as of June 30, 2012 reported in the Government-Wide Financial Statements, which is based on 61% usage (filled) of the landfill. It is estimated that an additional \$10,828,236 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 (\$28,692,500) 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, 2012. 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 \$222,300 in a bank account held for landfill improvements, and has a balance due from the general fund of \$440,000.

7. **Department of Labor Debt-** - These amounts represent the balance owed to the Agency for various quarterly reports not paid as of June 30, 2012.

8. **Claims and Judgments-** - These amounts represent the balance related to legal claims at June 30, 2012, 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, 2012:

<u>Year Ending June 30,</u>	<u>Total</u>
2013	\$ 626,368
2014	311,108
2015	263,348
2016	256,267
2017	216,367
Beyond	<u>853,950</u>
Total minimum payments required	<u>\$ 2,527,408</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.

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.

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>
2012	\$ 812,173	\$ 788,262
2011	\$ 287,753	\$ 490,780
2010	\$ 615,397	\$ 511,207

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, 2012, a copy of which can be obtained from the Retirement System, Minillas Station, PO Box 42003, San Juan, PR 00940.

14. FUND BALANCE (DEFICIT)

As of June 30 2012, fund balance (deficit) is comprised of the following:

<u>Fund Balance (Deficit)</u>	<u>General Fund</u>	<u>Special Revenue Fund- Head Start</u>	<u>Capital Projects Fund-State & Local Grants</u>	<u>Debt Service Fund</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Restricted for:						
General Government	\$ 152,198	\$ -	\$	\$	\$ 917	\$ 153,115
Culture and Recreation					1,100	1,100
Health and Welfare					992,745	992,745
Public Safety					600	600
Capital Projects			17,135,434			17,135,434
Education					15,214	15,214
Debt Service				10,123,610		10,123,610
Public Works					238,122	238,122
Committed:						
General Government					287,718	287,718
Culture and Recreation					13,883	13,883
Health and Welfare					84,430	84,430
Public Safety					11,162	11,162
Education					219,843	219,843
Public Works			1,338,707		32,878	1,371,585
Unassigned	<u>(17,936,525)</u>		<u>(213,183)</u>		<u>(604,124)</u>	<u>(18,753,832)</u>
Total Fund Balance (Deficit)	<u>(\$17,784,327)</u>	<u>\$ -</u>	<u>\$ 18,260,958</u>	<u>\$ 10,123,610</u>	<u>\$ 1,294,488</u>	<u>\$ 11,894,729</u>

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 \$690,922 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, 2012 the general fund had commitments of approximately \$3.3 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, 2012:

- a. GASB Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements (GASB 60). The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. This Statement is effective for periods beginning after December 15, 2011.

17. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (CONTINUED)

- b. GASB Statement No. 61, The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34 (GASB No. 61). The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, The Financial Reporting Entity, and the related financial reporting requirement of Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments, were amended to better meet user need and to address reporting entity issues that have arisen since the issuance of those Statements. This Statement is Effective for periods beginning after June 15, 2012.
- c. GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA pronouncements. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements; 1) Financial Accounting Standard Board (FASB) Statements and interpretations, 2) Accounting Principles Boards Opinions, 3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedures. This Statement is effective for periods beginning after December 15, 2011.
- d. GASB Statement No. 63, Financial Reporting Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position. The objective of this Statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, Elements of Financial Statements, introduced and defined elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.
- e. GASB Statement No. 65, Items Previously Reported as Assets and Liabilities. The objective of this Statement is to establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determinations of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

17. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (CONTINUED)

- f. GASB Statement No. 66, Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

Post fiscal year 2012-2013

- a. GASB-67 Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25 is effective for periods beginning after June 15, 2013.
- b. GASB-68 Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27 is effective for periods beginning after June 15, 2014.

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	Capital Projects Fund-Local, State, and Federal Grants	Debt Service Fund	Other Governmental Funds	Total
Fund balance beginning	(\$10,357,444)	\$ -	\$ 23,499,785	\$9,425,380	\$ 1,870,894	\$24,438,615
To restate interfund transactions deemed uncollectible	(573,897)	-	-	-	-	(573,897)
Fund balance, beginning as restated	(\$10,931,341)	\$ -	\$ 23,499,785	\$9,425,380	\$ 1,870,894	\$23,864,718

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	\$ 67,164,128
To restate interfund transactions deemed uncollectible	<u>(573,897)</u>
Net assets, beginning as restated	<u>\$ 66,590,231</u>

19. SUBSEQUENT EVENTS

On August, 22, 2012, the Municipal Legislature approved the issuance of a general obligation bond for the amount of \$505,000, for cash flow deficiencies. Repayment of the bond is scheduled from July 2013 through July, 2037.

On January 29, 2013, the Municipal Legislature approved an increase in tax rates for real and personal property. The Additional Special Contribution tax rate will increase from (2.75%) to three point five percent (3.50%) for real and personal property. The new tax rates will apply on January 1, 2013, and on July 1, 2013 the CRIM will begin its billing and collection.

On January 29, 2013, the Municipal Legislature authorized the Mayor to use \$2,000,000 from Government of Puerto Rico Legislature's Joint Resolution 243-2012, for operational and administrative expenditures. The original amount of the Resolution was \$3,000,000 for payment of employees' salaries and Christmas bonuses.

In Ordinances 28 and 37, approved by the Municipal Legislature on January 15 and January 29, 2013, respectively, the legislative body authorized the Mayor to establish financial and administrative policies due to fiscal emergency. This Ordinances establish policies of personnel management, awarding of existent and future contracts, equipment acquisition, determining and collecting accounts receivable, legislative body expenditures, use of municipal vehicles, waste management, land disposition, use of facilities fees, sale of advertisement spots, service fees, and joint ventures with other government agencies and municipalities to provide services.

19. SUBSEQUENT EVENTS (CONTINUED)

On April 9, 2013, the Municipal Legislature approved an amnesty for the payment of one percent (1%) from the sale and use tax applicable to the Municipality. Law 117-2006 established the applicability of a uniform rate of 1.5% of sales and use tax for the municipalities of Puerto Rico. One percent (1%) will be collected by the Municipality and 0.5 by Government of Puerto Rico's Department of Treasury. It is over this one percent (1%) that this amnesty was approved. The amnesty will be in effect from April 9, 2013 through June 28, 2013.

On April 9, 2013, the Municipal Legislature approved an amnesty for the payment of interests and penalties on taxpayers' municipal license taxes debts. Mainly, the amnesty is for debts of more than five (5) years. An interest rate of 5% over the amount due will be the only charge applied. The amnesty will be in effect from April 9, 2013 through June 30, 2013.

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	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note 1)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES				
Property taxes	\$ 10,642,616	\$ 10,642,616	\$ 11,935,221	\$ 1,292,605
Municipal license tax	10,560,000	10,560,000	7,523,123	(3,036,877)
Sales and use tax	5,450,000	5,450,000	2,984,545	(2,465,455)
Licenses, permits and other local taxes	4,575,000	4,575,000	1,183,112	(3,391,888)
Charges for service	1,365,000	1,365,000	220,015	(1,144,985)
Intergovernmental	10,619,331	10,641,933	10,534,966	(84,365)
Rent of property	350,000	350,000	178,695	(171,305)
Fines and forfeitures	225,000	225,000	72,127	(152,873)
Interest	300,000	300,000	695,435	395,435
Miscellaneous	<u>1,350,000</u>	<u>1,350,000</u>	<u>1,024,757</u>	<u>(325,243)</u>
Total revenues	<u>45,436,947</u>	<u>45,436,947</u>	<u>36,351,996</u>	<u>(9,084,951)</u>
EXPENDITURES, ENCUMBRANCES AND OTHER				
FINANCING USES:				
Current:				
General government	\$ 28,366,160	\$ 28,366,160	\$ 22,826,955	\$ 5,539,205
Public safety	4,820,215	4,820,215	4,241,831	578,384
Public works	8,976,754	8,976,754	8,451,992	524,762
Culture and recreation	1,912,898	1,912,898	1,596,939	315,959
Operating transfer to other fund	<u>1,360,920</u>	<u>1,360,920</u>	<u>1,360,920</u>	<u>-</u>
Total expenditures, encumbrances and other financing uses	<u>\$ 45,436,947</u>	<u>\$ 45,436,947</u>	<u>\$ 38,478,637</u>	<u>\$ 6,958,310</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (2,126,641)</u>	<u>\$ (2,126,641)</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 36,351,996
Differences-budget to USGAAP:				
Long term debt issued				7,840,000
Non-budgeted transfer in				894,482
USGAAP adjustments to revenues				<u>(49,724)</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 45,036,754</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 38,478,637
Differences-budget to USGAAP:				
Prior year encumbrances recorded as current year expenditures for USGAAP basis				8,836,999
Current year encumbrances recorded as expenditures for budgetary basis				(3,284,426)
Non-budgeted transfer out				209,234
Non-budgeted expenditures				<u>7,649,296</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 51,889,740</u>

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, 2012 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2012.

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Commonwealth of Puerto Rico Department of Education:			
Child and Adult Care Food Program	10.558	Not Available	<u>\$ 1,074,130</u>
Total U.S. Department of Agriculture			<u>1,074,130</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Program:			
Community Development Block Grants/Entitlement Grants-Cluster	14.218		2,601,190
Direct Program:			
Urban Development Action Grant	14.221		2,564
Direct Program:			
Emergency Shelter Grants Program	14.231		71,681
Direct Program:			
HOME Investment Partnerships Program	14.239		683,256
Direct Program:			
ARRA-Community Development Block Grant ARRA Entitlement Grant(CDBG-R) (Recovery Act funded)	14.253		18,551

<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		783,963
Direct Program: Section 8 Housing Choice Voucher Program	14.871		<u>4,435,623</u>
Total U.S. Department of Housing and Urban Development			<u>8,596,828</u>
U.S. DEPARTMENT OF JUSTICE			
Pass-through the Puerto Rico Department of Justice: Victims of Crime Act (VOCA)	16.575	2010-VA-GX-0093	8,278
Pass-through the Commonwealth Office of the Governor (CFWM): Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	Not Available	<u>69,935</u>
Total U.S. Department of Justice			<u>78,213</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Direct Program: ARRA-Transit Capital Assistance Grants- Urbanized Area Funding Program	20.509		<u>160,650</u>
Total U.S. Department of Transportation			<u>160,650</u>

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF ENERGY:			
Direct Programs:			
ARRA – Energy Efficiency and Conservation Block Grant	81.128	SC0002949	536,938
Total U.S. Department of Energy			536,938
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	319,957
Special Programs for Aging – Title III, Part C – Nutrition Services	93.045	Not Available	73,457
Nutrition Services Incentives Program	93.053	Not Available	33,306
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN):			
Community Services Block Grant	93.569	Not Available	29,049
Child Care and Development Block Grant	93.575	Not Available	795,546
Head Start Program	93.600	Not Available	10,230,707
Total U.S. Department of Health and Human Services			11,482,022

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-through the Commonwealth of Puerto Rico -Emergency Management Agency			
Disaster Grants - Public Assistance	97,036	Not Available	<u>82,720</u>
Total U.S. Homeland Security			<u>82,720</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 22,011,501</u>

The accompanying notes are an integral part of this schedule.

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>Other Governmental Funds</u>	<u>Total</u>
Per Schedule of Expenditures of Federal Awards	\$ 11,247,666	\$ 10,763,835	\$ 22,011,501
Non federal programs expenditures	-	<u>595,397</u>	<u>595,397</u>
Total expenditures in the basic financial statements	<u>\$ 11,247,666</u>	<u>\$ 11,359,232</u>	<u>\$ 22,606,898</u>



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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, 2012, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated July 22, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the **Municipality of Arecibo** is responsible for establishing and maintaining effective 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 **12-01** through **12-04**, and **12-26** 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 a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as item **12-05** to be a significant deficiency.

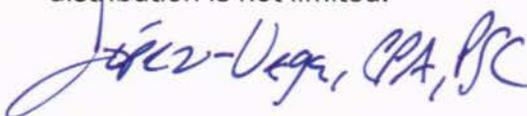
Compliance and Other Matters

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 items **12-03 and 12-26**.

We noted certain other matters that we reported to management of the **Municipality of Arecibo** in a separate letter dated July 22, 2013.

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
July 22, 2013

Stamp No. 2675754 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, 2012. 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.

As described in items **12-07, 12-17, 12-22, and 12-24**, in the accompanying schedule of findings and questioned costs, the **Municipality of Arecibo** did not comply with the requirements regarding allowable costs/cost principles, and matching that are applicable to Head Start Program (CFDA No.93.600); with requirements regarding allowable costs/cost principles applicable to Child and Adult Care Food Program (CFDA No. 10.558); and with requirements regarding special test applicable to Section 8 Housing Choice Voucher Program (CFDA No. 14.871). Compliance with such requirements is necessary, in our opinion, for the **Municipality of Arecibo** to comply with the requirements applicable to those programs.

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)

In our opinion, except for the noncompliance described in the preceding paragraph, 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, 2012. The results of our auditing procedures also disclosed other 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 **12-06**, **12-08** through **12-16**, **12-18** through **12-21**, **12-23**, and **12-25**.

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 the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Municipality of Arecibo's** internal control over compliance.

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or 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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items **12-07**, **12-17**, **12-22**, and **12-24** to be material weaknesses.



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)

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items; **12-06, 12-08 through 12-16, 12-18 through 12-21, 12-23, and 12-25** to be significant deficiencies.

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** responses and, accordingly, we express no opinion on the responses.

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Arecibo** in a separate letter dated July 22, 2013.

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
July 22, 2013

Stamp No. 2675755 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

Section I – Summary of Auditor's Results
Financial Statements

Type of auditor's report issued:	Qualified	FFS,	and	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	X		No	

Federal awards

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

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
10.558	Child and Adult Care Food Program
	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
14.257	ARRA-Homelessness Prevention and Rapid Re-housing
14.871	Section 8 Housing Choice Voucher
93.575	Child Care & Development Block Grant
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B programs	<u>\$660,345</u>
Auditee qualified as low-risk auditee?	Yes No X

Section II – Financial Statements Findings

Finding Reference **12-01**

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 provide 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.

Due to the lack of proper accounting internal controls, the Municipality was not able to maintain complete, updated and accurate accounting records for expenditures incurred and unpaid at the Balance Sheet date. We were unable to obtain sufficient evidence to determine the completeness of the amounts recorded as accounts payable amounting to \$4,881,237 in the General Fund in the Balance Sheet at June 30, 2013. Also, the Municipality did not submit for our examination thirty four (34) disbursement vouchers related to our search for unrecorded liabilities test. Disbursement vouchers not provided for our examination amounted to \$622,969.

In addition, during fiscal year 2011-2012, the Municipality failed to prepare bank conciliations for its Local, State and Federal accounts on a timely manner. Bank conciliations were prepared by an external accounting firm more than a year overdue for the purpose of preparing the Budget Liquidation report for said fiscal year.

Section II – Financial Statements Findings

Finding Reference **12-01 (Continued)**

Also, 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 and the preparation of its bank conciliations. Also, the accounting data is not summarized in the form of a double-entry general ledger record.

In addition, 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

Section II – Financial Statements Findings

Finding Reference **12-01 (Continued)**

Management Response
And Corrective Action

We concur with this finding. A major goal of the Municipality's Department of Finance is to improve the quality of its current accounting, auditing, and financial reporting practices. Since January 2013, the Department of Finance is being adopting several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate all of the deficiencies in the current accounting system used by the Municipality and reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The principal of the abovementioned internal control measures adopted by the Municipality is the establishment of a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside consultants.

Such team will work together throughout the year to prepare the Municipality's financial statements, including all of the accounting records and reports needed to support the balances and disclosures reported in the financial statements as of and for the fiscal year ended June 30, 2013 and thereafter. These control measures will minimize the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality's basic financial statements.

This conclusion is evidenced by the following expected results: (1) the Independent Auditors' Report on the Municipality's financial statements is expected to be unqualified for the fiscal year ended June 30, 2013, and (2) audit adjustments to be recorded in the financial statements will be minimal and not material to the financial statements taken as a whole.

In addition, during the fiscal year 2012-2013, the Municipality is completing the first stage of the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations, including all the requirements established by generally accepted accounting principles.

Section II – Financial Statements Findings

Finding Reference **12-01 (Continued)**

The management of the Municipality understands that the alternative of accounting system currently being implemented will provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements. The period of time required to annually carry out the Single Audit would be substantially reduced.

The Municipality expects that the implementation project will be completed during calendar year 2013. As part of this project, the Department of Finance will establish and document new accounting policies and procedures. Accounting policies and procedures will be promulgated by an appropriate level of management to emphasize their importance and authority. The documentation of such accounting policies and procedures will be updated periodically according to a predetermined schedule.

In addition, the Department of Finance will improve its fund accounting by evaluating, within the next year, its fund structure to ensure that individual funds that have become superfluous, if any, are eliminated.

Responsible Person: Ms. Carmen Paniagua- Director of Finance

Implementation date: The implementation of the new accounting system is expected to be completed by June 30, 2013

Section II – Financial Statements Findings

Finding Reference 12-02

Requirement Operating deficit of general fund

Statement of Condition The Municipality closed its fiscal year ended June 30, 2012 with an accumulated deficit of \$17,784,327. The Municipality's internal control relating to the budgeting function does not adequately prevent management from incurring expenditures in excess of the appropriated funds. In addition, the deficit was caused by the overstatement of estimated revenues and incurring in obligations without available credit in the budgetary accounts.

Criteria Article 7.011, Section (a) of Autonomous Municipal Act (Law 81) establishes that if the Municipality close its operations on deficit it must provide for sufficient resources to cover it during the next fiscal year. Section (b) establishes among other things, that provides that accrued deficit in the Municipality, by public debt, will be amortized in a period of 40 years. The equivalent amortization amount will be established in an expenditures account in the annual budget known as accrued deficit which will be indicated in the chart of accounts.

Article 8.004 (b) of the Municipalities Law establishes that the Municipality cannot obligate or spend funds in excess of the ensuing fiscal year. No amount shall be expended or obligated in a given fiscal year if exceeds its budgeted or authorized amounts by the Municipal Legislation.

Section 3 of the revised regulation over Basic Standards for Municipalities of Puerto Rico (The regulation) states that special care must be taken to prepare the revenues estimates so these will not results in budget appropriations in excess of available resources.

Cause of Condition This situation occurs because the Municipality is appropriating expenditures assuming the future collection of revenues using estimated tax collection provided the Budget Division Office and Municipal Revenue Collection Center. Therefore, the Municipality enters into purchases and contracts exceeding the actual taxes revenues earned and collected. The budgeting system does not reflect actual revenues and therefore cannot prevent the obligation of expenditures for which current resources will not be available. The overstatement of estimated revenues and the incurrance of obligations without available credit caused the Municipality to operate with a deficit.

Section II – Financial Statements Findings

Finding Reference 12-02 (continued)

Effect of Condition The Municipality did not comply with the Article 7.011, Section (a), Article 8.004 (b) and Section 3 of the revised regulation over basic Standard for Municipalities of Puerto Rico.

The continued occurrence of this situation could result in possible significant limitations on available funds and eventual reduction or elimination of municipal services since future collection of revenues will need to be used to pay for accumulated liabilities.

Recommendation We recommend management to evaluate the adequacy of the provision for deficit reserve accounts during the next fiscal year budget for the amortization of public debt as recommended by Law. Also, the Municipality's officers must evaluate the negative variances between budgeted revenues and actual revenues trend to reduce the budgeted expenses by department (quarterly allocation process) and to avoid future operational deficits at end of year.

Questioned Costs None

Management Response

and Corrective Action We concur with this finding. The new municipal administration that took governance on January 2013 acknowledges the provisions of Article 7.011, Section (a) of the Autonomous Municipalities Act of Puerto Rico (commonly known as Law No. 81). As an immediate corrective action, the Municipality will provide sufficient budgetary resources in the 2013-2014 operating budget of the general fund to start the statutory amortization of the accumulated budgetary deficit through a period of forty years. A similar budgetary appropriation will be made in subsequent yearly budgets through year 2052.

In addition, the Director of Finance will take the necessary actions to ensure that the process of determining the revenue estimates used in the preparation of the annual operating budget are more accurately performed and are monitored on a monthly basis. The Director of Finance will also recommend the Municipal Legislature periodic and timely amendments to the annual operating budget of the Municipality to avoid budgetary overruns at the end of each fiscal year.

Responsible Person: Ms. Carmen Paniagua- Director of Finance

Implementation date: June 30, 2013 through June 30, 2053.

Section II – Financial Statements Findings

Finding Reference **12-03**

Requirement **Municipal license tax revenues**

Statement of Condition Municipal license tax revenues of the fiscal year 2012-2013, which were collected in advance from taxpayers between January 1 and June 30, 2012 (known in Spanish as "Patente en Suspenso"), were used by the Municipality to cover certain operating costs and cash flows shortages of the general fund incurred during the fiscal year ended June 30, 2012. Those unearned revenues collected in advance pertain to the general fund's operating budget of the fiscal year 2012-2013, and could not be used to pay obligations of the prior year. These transactions were not authorized by Municipal Legislature, through an 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 current fiscal year.

Section II – Financial Statements Findings

Finding Reference **12-03 (Continued)**

Questioned Costs None

**Management Response
and Corrective Action**

We partially concur with this finding. The Director of Finance of the new municipal administration that took governance on January 2013 will take the necessary actions to ensure that the process of determining the revenue estimates used in the preparation of the annual operating budget are more accurately performed and are monitored on a monthly basis, principally the revenue estimates of the municipal license taxes, which are the second largest revenue streams of the Municipality and susceptible to the economic conditions of Puerto Rico. The Director of Finance will also recommend the Municipal Legislature periodic and timely amendments to the annual operating budget of the Municipality to avoid budgetary overruns at the end of each fiscal year.

At June 30, 2012, the accounting records of the Municipality include a special fund which includes the financial resources of the unearned municipal licenses collected through June 30, 2012. In addition, there is no legal requirement that prohibits the use of the cash resources arising from unearned municipal licenses. The limitations set forth by Article 8.004(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81) are only for budgetary purposes not cash flows purposes.

Responsible Person: Ms. Carmen Paniagua- Director of Finance

Implementation Date: July 1, 2013

Section II – Financial Statements Findings

Finding Reference	12-04
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.
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 accounts 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>
Effect of Condition	<p>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.</p>
Recommendation	<p>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.</p>

Section II – Financial Statements Findings

Finding Reference **12-04 (Continued)**

Questioned Costs None

Management Response

And Corrective Action We concur with this finding. As an immediate corrective action, the Municipality will establish the necessary controls and procedures to assure that all deposits prepared on a daily basis are deposited in the correct bank account. For these purposes, the Director of Finance immediately will carry out a meeting with all collection officials of the Department of Finance to give specific instructions as to the reinforced procedures to be implemented regarding the proper classification and deposit of all cash receipts. However, we should mention that all of the above deposits are being currently identified by the cash reconciliation accountants of the Department of Finance. This means that the internal controls and procedures currently being adopted over the cash reconciliations will minimize the aforementioned risks and consequently the cash deposits were ultimately correctly deposited in the corresponding bank accounts.

Responsible Person: Ms. Carmen Paniagua- Director of Finance

Implementation Date: July 1, 2013

Section II – Financial Statements Findings

Finding Reference	12-05
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> <ul style="list-style-type: none">a. In one (1) case, the employee's time assistance card do not agree with compensated absence card.b. In six (6) cases, the employee wage rate per file do not agree with payroll records.c. 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.
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

Section II – Financial Statements Findings

Finding Reference **12-05 (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: Human Resources and Human Capital Director

Implementation Date: July 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **12-06**

Program **Child and Adult Care Food Program CFDA (10.558) U.S. Department of
Agriculture; Pass through State – Commonwealth of Puerto Rico
Department of Education**

Requirement **Financial Management-Bank Conciliations**

Statement of Condition **Section II – Financial Statements Findings- Finding Reference 12-01.**

Section III – Federal Award Findings and Questioned Costs

Finding Reference	12-07
Program	Child and Adult Care Food Program CFDA (10.558) U.S. Department of Agriculture; Pass through State – Commonwealth of Puerto Rico Department of Education
Requirement	Allowable costs/Cost principles
Statement of Condition	In March and April 2012, funds were transferred from the Food Program operating account to the Head Start Program account for the amount of \$320,000. That amount was reimbursed to the Food Program account in April 2012.
Criteria	7 CFR 226.15 (e) (13) states that documentation shall be collected and maintained so all Program reimbursement funds are used: (i) solely for the conduct of the food service operation; or (ii) to improve such food service operations, principally for the benefit of the enrolled participants.
Cause of Condition	Restricted funds from the federal program were transferred to another federal program for operating expenditures.
Effect of Condition	The Municipality did not comply 7 CFR 226.15 (e) (13).
Recommendation	We recommend that management should implement procedures to avoid the transfer of restricted federal funds to other federal programs' accounts.
Questioned Costs	None
Management Response And Corrective Action	The Program is aware of the situation and insists it is an isolated event. The Program has its internal controls in place to prepare timely bank conciliations and its personnel has the proper training to identify accounting transactions and differences between books and the Municipality's accounting records. However, if a functionary in the Municipality's Finance Department has the authority and willingness to drawdown from any bank account without express written consent of federal programs, we understand is an internal control deficiency from the Municipality. Nevertheless, our Programs' accounting department will stay vigilant and will review all processes so that this situation will not happen in the future.

Responsible Person: Ms. Carmen Paniagua- Director of Finance

Implementation Date: July 1, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-08

**Program Community Development Block Grant/Entitlement Grants (CFDA
14.218); U.S. Department of Housing and Urban Development**

Requirement Financial Management-Bank Conciliations

Statement of Condition Section II – Financial Statements Findings- Finding Reference 12-01.

Section III – Federal Award Findings and Questioned Costs

Finding Reference	12-09
Program	Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Cash Management
Statement of Condition	During our audit procedures, we examined a sample of thirty (30) fund requisitions and identified ten (10) cases in which the program did not pay its obligations in the time required by Federal Regulations. In one (1) case, \$2,800 were requested, but were not disbursed in the fiscal year due to an error in the disbursement voucher.
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. Luis Cruz-Program Director

Implementation Date: July 1, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-10
Program	Community Development Block Grant-Entitlement Program (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Reporting
Statement of Condition	During our Financial Reporting test, we identified the following conditions: a) SF-425, Federal Financial Report (cash status only) was not available for quarter ended March 31, 2012.
Criteria	<p>24 CFR, Subpart I, Sec. 570.489 (d) (1) states that the States shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirements must be available for Federal inspection and must be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions.</p> <p>24 CFR, Subtitle A, Subpart C, Section 85.41 states (a) <i>General</i> (1) Except as provided in paragraphs (a) (2) and (5) of this section, grantees will use only the forms specified in paragraphs (a) through (e) of this section, and such supplementary or other forms as may from time to time be authorized by OMB, for: (i) Submitting financial reports to Federal agencies. Also, Section (b) states that grantees will use Standard Form to report the status of funds for all non-construction grants and for construction grants when required in accordance with 85.41(e)(2)(iii) of this section. (3) <i>Frequency</i>. The Federal agency may prescribe the frequency of the report for each project or program. However, the report will not specify the frequency of the report, it will be submitted annually. A final report will be required upon expiration or termination grant support. Besides, Section 85.41 (c) (ii) states that these reports will be used by the Federal agency to monitor cash advanced to grantees and to obtain disbursement or outlay information for each grant from grantees. The format of the report may be adapted as appropriate when reporting is to be accomplished with the assistance of automatic data processing provided that the information submitted is not changed in substance.</p>

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **12-10 (Continued)**

Cause of Condition The Program financial management failed to have available for examination by us during the application of planned audit procedures.

Effect of Condition The Program is not in compliance with the Code of Federal Regulation 24, Subpart I, Sec. 570.489 (d) (1) and Subpart C, Sec.85.41.

Recommendation We recommend that the Program should implement procedures in order to assure that all Financial Status Report are prepared and submitted on time. Also, we recommend that the Program's Management instruct the Program accounting staff to prepare financial reporting with accurate, current, and complete disclosure of the financial result of financially assisted activities.

Questioned Costs None

Management Response and Corrective Action The Program will strengthen its internal control and procedures in the preparation of the Federal Financial Report to comply with the established Federal Regulations. Also, we are going to give instructions to program's staff to submit quarterly the SF-425, Federal Financial Report.

Responsible Person: Mr. Luis Cruz-Program Director

Implementation Date: July 1, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-11
Program	Community Development Block Grant/Entitlement Grants (CFDA 14.218); U.S. Department of Housing and Urban Development
Requirement	Earmarking
Statement of Condition	We performed an Earmarking Test for Community Development Block Grant/Entitlement Program and after our procedures, we found that the Municipality has not complied with the seventy percent (70%) of the funds that must be used over a period of up to three years for activities that benefit low – and moderate – income persons.
Criteria	24 CFR sections 570.200(a) (3) and 570.208(a) established the criteria in determined low – and moderate – income benefits.
Cause of Condition	The Municipality's internal control and procedures failed to detect the earmarking requirement non compliance during the program year.
Effect of Condition	The Municipality is not in compliance with the 24 CFR sections 570.200(a) (3) and 570.208(a).
Recommendation	We recommend that the Municipality should strengthen its procedures in order to assure compliance with the program requirements.
Questioned Costs	None
Management Response and Corrective Action	The Municipality concurs with the finding. The Federal Programs Department will determine in consultation with HUD, the proper corrective action to correct this situation.

Responsible Person: Mr. Luis Cruz-Program Director

Implementation Date: July 1, 2013

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference	12-12
Program	Community Development Block Grant/Entitlement Grants (CFDA 14.218); 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: <ul style="list-style-type: none">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 two (2) participant files, the Final Determination Form, was not signed by all members of the Committee in charge of approving the donation.d. In twelve (12) 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.
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.
Cause of Condition	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 570.506.

Section III – Mayor Federal Award Program Findings and Questioned Costs

Finding Reference 12-12 (Continued)

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

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. Luis Cruz-Program Director

Implementation Date: July 1, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-13

**Program Home Investment Partnership Program (CFDA. No. 14.239); U.S.
Department of Housing and Urban Development**

Requirement Financial Management-Bank Conciliations

Statement of Condition Section II – Financial Statements Findings- Finding Reference 12-01.

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-14

Program Homelessness Prevention and Rapid Re-housing Program – Recovery Act Funded (CFDA. No. 14.257); U.S. Department of Housing and Urban Development;

Requirement Financial Management-Bank Conciliations

Statement of Condition Section II – Financial Statements Findings- Finding Reference 12-01.

Section III – Federal Award Findings and Questioned Costs

Finding Reference	12-15
Program	Homelessness Prevention and Rapid Re-housing Program – Recovery Act Funded (CFDA. No. 14.257); U.S. Department of Housing and Urban Development;
Requirement	Cash Management
Statement of Condition	During our audit procedures, we examined a sample of sixteen (16) fund requisitions and identified nine (9) cases in which the program did not pay its obligations in the time required by Federal Regulations. In two (2) cases, there was no documentation detailing payments made, to corroborate that the disbursements were made in a timely manner.
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. Luis Cruz-Program Director

Implementation Date: July 1, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-16

**Program Section 8 Housing Choice Vouchers (CFDA. No. 14.871); U.S.
Department of Housing and Urban Development**

Requirement Financial Management-Bank Conciliations

Statement of Condition Section II – Financial Statements Findings- Finding Reference 12-01.

Section III – Major Federal Program Award Findings and Questioned Costs

Finding Reference	12-17
Program	Section 8 Housing Choice Vouchers (CFDA. No. 14.871); U.S. Department of Housing and Urban Development
Requirement	Special Test-Operating Transfers and Administrative Fees
Statement of Condition	In February 2012, Section 8 Housing Choice Voucher funds were transferred to Head Start Program account as part of Municipality matching contribution for that program. Also, we identified transfers of funds to the Municipality's operating account resulting in a due from general fund of \$22,500 as of June 30, 2012.
Criteria	24 CFR Subpart D, Section 982.151 states that the Annual Contributions Contract (ACC) establishes the amounts HUD will provide a PHA for HAP and administrative fees. HAP may not be used to cover administrative expenses nor may HAP (including Net Restricted Assets – HAP (NRA)) be loaned, advanced, or transferred to other component units or other programs.
Cause of Condition	The Municipality performed unallowed transfer of funds to other federal program.
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 Department of Finance for the payment of any amount due from unallowed transfer of funds and require that this situation do not repeat in the future. Responsible Person: Mr. Wesley Rivera-Housing Director Implementation Date: July 1, 2013

Section III – Major Federal Program Award Findings and Questioned Costs

Finding Reference	12-18
Program	Section 8 Housing Choice Vouchers (CFDA. No. 14.871); U.S. Department of Housing and Urban Development
Requirement	Reporting
Statement of Condition	We performed a reporting test and noted that the audited financial data (submitted electronically) was not submitted to HUD through the Real Estate Assessment Center (REAC) in the stipulated time (March 31, 2013).
Criteria	OMB No. 2535-017, 24 CFR section 5.801, requires PHA to submit timely GAAP-based unaudited and audited financial information electronically to HUD through the Real Estate Assessment Center (REAC) sub-system.
Cause of Condition	The Program did not submit timely the audited financial data as 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 Municipality's management instruct the program accountant to submit timely GAAP-based audited financial information electronically to HUD once the Single Audit Report package is available.

Responsible Person: Mr. Wesley Rivera-Housing Director

Implementation Date: July 31, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **12-19**

Program **Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Administration for Children and Families**

Requirement **Financial Management-Bank Conciliations**

Statement of Condition **Section II – Financial Statements Findings- Finding Reference 12-01.**

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-20
Program	Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Cash Management-Time elapsed
Statement of Condition	We performed Cash Management Test and we found the following exceptions: <ul style="list-style-type: none"> 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	<p>The Municipality management agrees with the finding. For the last years this situation has been emphasized as a finding by the auditors. We have followed the procedures established by the pass-through agency to make the request of funds.</p> <p>However, in our efforts to work with this situation we established communication with the Fiscal Monitor of the Division during their monitoring intervention, and they could confirm our compliance with their procedures for cash management. We understand we can't establish a corrective action to this situation; it is the pass-through agency responsibility to establish procedures to distribute the funds.</p> <p>Responsible Person: Mrs. Ivette Nazario– Program Accountant</p> <p>Implementation date: July, 2013</p>

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-21
Program	Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through Commonwealth of Puerto Rico - Administration for Children and Families
Requirement	Reporting
Statement of Condition	During our reporting test we could not trace the amounts presented in Financial Reports (Monthly Reports and Annual Closing Report) to the accounting records.
Criteria	Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1) states that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub grant.
Cause of Condition	The Municipality internal control failed to assure that the financial and programmatic reports were prepared according to Federal and State Regulations.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (1), provisions regarding financial reporting.
Recommendation	We recommend that the Municipality should establish internal controls and procedures in order to assure that accurate accounting records are maintained and current and complete disclosure of financial results are presented in the financial reports.
Questioned Cost	None
Management Response And Corrective Action	The requests of funds are submitted to the pass-through agency quarterly. The first requisition is submitted on October and it includes estimated costs amounts related to the first quarter (October to December). Because those are estimated cost amounts no necessarily will represent the actual amounts incurred as expenditures during the quarter, and the drawdown received, either. This is part of the procedures established by the pass-through agency to distribute the budget approved to the Municipality. The approved budget is divided in four parts that will be transfer to the Municipality quarterly, according to the requisition of funds.

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-21 (Continued)

Also, The Municipality of Arecibo has implemented a payroll system on a bi-weekly payoff and the reports we sent to the pass-through entity are prepared with the payroll expenditures incurred monthly, so differences will arise from the accounting records. We understand this is not a concern that can affect the operation and the compliance with the funds granted, because the reports included an additional column to make adjustments and at the end of the year the reports will present the total drawdowns and the actual cost incurred. In the final report the amount expended are included and if an excess of funds in hand results we proceed to return the funds to the pass-through entity.

Responsible Person: Mrs. Ivette Nazario

Implementation date: July, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-22
Program	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
Requirement	Allowable costs/Cost principles
Statement of Condition	In March 2012, the Municipality performed two (2) electronic funds transfer (EFT) from the Head Start Program account to the Municipality's operating account. As of the date of our examination, we could not verify the intended use of this transfer of funds. The amounts transferred amounted to \$210,000.
Criteria	CFR 45, Subpart C, Section 92.20 (b) (3), states that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.
Cause of Condition	The Municipality failed to safeguard all grants property and assure the proper and authorized use of federal funds.
Effect of Condition	The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b) (3).
Recommendation	We recommend management to strengthen its internal controls to identify transfer of funds between Municipality's bank accounts.
Questioned Costs	\$210,000
Management Response And Corrective Action	The Program is aware of the situation and insists it is an isolated event. The Program has its internal controls in place to prepare timely bank conciliations and its personnel has the proper training to identify accounting transactions and differences between books and the Municipality's accounting records. However, if a functionary in the Municipality's Finance Department has the authority and willingness to drawdown from any bank account without express written consent of federal programs, we understand is an internal control deficiency from the Municipality. Nevertheless, our Programs' accounting department will stay vigilant and will review all processes so that this situation will not happen in the future. Responsible Persons: Ms. Carmen Paniagua-Director of Finance. Implementation date : Inmediately

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-23
Program	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
Requirement	Cash Management-Time elapsed
Statement of Condition	We performed 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 requisition of funds system established by the Government of Puerto Rico Child Care and Development Administration (ACUDEN) has been designed to request funds on a monthly basis. We complete and submit the request of funds form provided by ACUDEN, requesting funds based on cash received to date, cash outlay obligations and a forecast of expenditures for the next month (payroll, fringe benefits, contracts, services, etc.) We will give instructions to strengthen the internal controls and the procedures to minimize the time between the receipts of the request of funds and the disbursements.

Responsible Person: Mrs. María Torres – Program Accountant

Implementation date : July, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-24

Program 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

Requirement Matching

Statement of Condition During February 2012, the Municipality had not complied with Head Start Program matching contribution for the health plan of the program's employees. Because of the cash flow situation, the Municipality transferred funds from the Section 8 Housing Voucher Program (\$152,749) to the Head Start Program. In addition, \$320,000 from Food Program funds were transferred to Head Start operating accounts from March 2012 through April 2012 for operating expenditures. Those amounts were reimbursed to the proper funds.

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; (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 used unallowed funding to comply with its matching contribution.

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-24 (Continued)

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: The Program is aware of the situation and insists it is an isolated event. The Program has its internal controls in place to prepare timely bank conciliations and its personnel has the proper training to identify accounting transactions and differences between books and the Municipality's accounting records. However, if a functionary in the Municipality's Finance Department has the authority and willingness to drawdown from any bank account without express written consent of federal programs, we understand is an internal control deficiency from the Municipality. Nevertheless, our Programs' accounting department will stay vigilant and will review all processes so that this situation will not happen in the future. Also, the Program will require the Municipality to comply with the matching of funds per agency agreement contract.

Responsible Person: Ms. Carmen Paniagua-Director of Finance.

Implementation Date: Inmediately

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 12-25

Program 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

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. Two (2) contracts did not include a provision for compliance with Executive Order 11246 "Equal Employment Opportunity".
- d. One (1) contract did not include provisions for Davis Bacon Act.
- e. One (1) contract did not include provisions for Sections 103 and 107 of the contract Work House & Safety Standards Act.
- f. One (1) contract did not include provisions for Clean Air and Water Act.
- g. Two (2) contract did not include provisions for Energy Policy and Conservation Act.
- h. One (1) contract did not include provisions for Copeland 'Anti-kickback'.

Criteria Code of Federal Regulations 45, Subpart C, Section 92.36 (I) (1-13), states that sub-grantee's contract must contain provisions described in paragraph (I) 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, (I) (1-13).

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **12-25 (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

Implementation Date: July, 2013

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	12-26
Requirement	Single Audit Act
Statement of Condition	The Single Audit Report for the fiscal year ended June 30, 2012, was issued more than one year after fiscal year ended.
Criteria	The Single Audit Act of 1984, as amended, require that the audit report must be submitted to the Federal Audit Clearinghouse no later than nine months after the end of the audit period.
Cause of Condition	The Municipality did not comply with the established regulation as prescribed in OMB Circular A-133.
Effect of Condition	The Municipality could lose federal grants since the noncompliance with Act requirements.
Recommendation	Procedures should be implemented to ascertain that the Municipality complies with the established Federal Regulation, as prescribed by OMB Circular A-133.
Questioned Costs	None
Management Response And Corrective Action	We concur with this finding. The Municipality will establish a <i>Financial Reporting Task Force</i> composed of the management team of the Department of Finance and outside consultants. We expect the Single Audit reporting package for June 30, 2013 to be available on or before March 31, 2014.

Responsible Person: Ms. Carmen Paniagua- Director of Finance

Implementation Date: July 1, 2013

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
11-05	14.218	<p><u>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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 12-09.</p>
11-06	14.218	<p><u>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.</u></p> <p>Full corrective action has been taken.</p>
11-07	14.218	<p><u>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 was 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 its original footing. No evidence of Governmental Agencies approval of structure construction, sanitary and electrical permits were found.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 12-12.</p>
11-08	14.239	<p><u>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</u></p>

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>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. 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.</u></p> <p>No corrective action has been taken. At the date of our examination, the \$52,000 repayment has not been made.</p>
11-09	14.871	<p><u>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).</u></p> <p>Full corrective action has been taken.</p>
11-10	93.575	<p><u>We performed 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.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 12-20.</p>
11-11	93.600	<p><u>We performed Cash Management Test and we found the following exceptions: a) The program requested funds that were not disbursed on a reasonable lapse of time.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 12-23.</p>
11-12	93.600	<p><u>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.</u></p> <p>Full corrective action was taken.</p>

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
11-13	93.600	<p><u>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.</u></p> <p>Partial corrective action has been taken. The auditors issued a finding relating to the In-kind contributions, not the matching documentation.</p>
11-14	93.600	<p><u>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'.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 12-25.</p>
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>

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
10-08	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> <p>Full corrective action has been taken.</p>
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>Full corrective action has been taken.</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>

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.
10-15	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 12-20.</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>
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 12-23.</p>
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>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse.</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>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse.</p>