

Comisión de Control de los Gobiernos Municipales

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF ARROYO

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

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Year Ended June 30, 2012

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

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

FISCAL YEAR ENDED JUNE 30, 2012

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

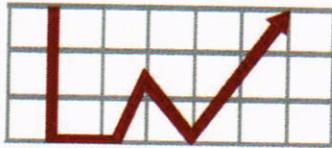
BASIC FINANCIAL STATEMENTS  
WITH ADDITIONAL REPORTS AND INFORMATION  
REQUIRED BY THE SINGLE AUDIT ACT

FISCAL YEAR ENDED JUNE 30, 2012

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*López-Vega, CPA, PSC*

Certified Public Accountants / Management Advisors

Member of:

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

### INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Autonomous **Municipality of Arroyo, Puerto Rico (Municipality)**, 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 Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 10 the financial statements, the Municipality did not comply the requirements established by Statement No. 18, Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs, issued by the Governmental Accounting Standards Board and the regulations set forth by the U.S. Environmental Protection Agency. At June 30, 2012, the accompanying statement of net assets does present a liability for closure and post closure care costs of the Municipality's solid waste landfill of \$1,694,062, but this estimate has not been update based on a study of the actual landfill capacity used at June 30, 2012. The amount by which departure would affect the liabilities, net assets and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matters discussed in the third paragraph, the financial statements referred to previously do not present fairly, in all material respects, the respective financial position of the governmental activities of the **Municipality of Arroyo, Puerto Rico**, as June 30, 2012, the changes in the financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

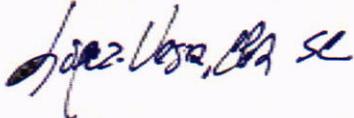
Further, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of each major fund and the aggregate remaining fund information for the aggregated remaining fund information of **Municipality of Arroyo**, as of June 30, 2012, and the respective changes in the financial position for the year ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 5, 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 that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

**INDEPENDENT AUDITORS' REPORT (CONTINUED)**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages **3** through **12** and **48** be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with the auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Arroyo's** financial statements. The 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 is 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 information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepared the financial statements or the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures and 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  
March 5, 2012

Stamp No. 2632084 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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The management of **Municipality of Arroyo**, Puerto Rico (**Municipality**) offers this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2012. The Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, and much of the information is comparable to prior year. This MD&A should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements.

During the fiscal year 2003-2004 was implemented the reporting model required by Governmental Accounting Standards Board Statement No. 34. 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:

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

#### **FINANCIAL HIGHLIGHTS**

The following are key financial highlights for the fiscal year:

- ❖ The Municipality's assets exceeded its liabilities at June 30, 2012 by \$20,204,087, and at June 30, 2011 by \$19,903,239, as restated;
- ❖ During the fiscal year 2011-2012; the Municipality's total net assets increased by \$300,848
- ❖ As of June 30, 2012, the Municipality's governmental funds reported combined ending fund balance of \$3,379,410, a decrease of \$ (2,514,737) from the prior year;
- ❖ At June 30, 2012, the Statement of Net Asset presented an unrestricted deficit of \$(8,639,644);
- ❖ The Municipality's capital assets inventory increase as a result of this year's operations. Capital assets as of June 30, 2012 were \$34,812,853 (net of accumulated depreciation);
- ❖ The investment in capital assets for this year was \$24,991,051 (net of related debt);
- ❖ Loans principal payments were \$436,000 and \$323,000 in 2012 and 2011, respectively.

#### **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

This discussion and analysis are intended to serve as an introduction to the Municipality's financial statements. The Municipality's basic financial statements comprise three components: government-wide financial statements; fund financial statements; and notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The government-wide financial statements are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements can be found immediately following this MD&A. These financial statements are designed to provide readers with a broad overview of the Municipality's finances, in a manner similar to a private-sector business.

**STATEMENT OF NET ASSETS**

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

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

**STATEMENT OF ACTIVITIES**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2012, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in the statement of activities are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although the statement of activities looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial enterprise represents its net income, the Municipality reports an amount described as net change in net assets, which is essentially the same concept.

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**GOVERNMENT-WIDE FINANCIAL STATEMENTS (CONTINUED)**

Both of the government-wide financial statements of the Municipality are principally supported by taxes and intergovernmental revenues. The governmental activities of the Municipality include; mayor and municipal legislature, general government, public safety, public works, culture and recreation, health and sanitation, human services and welfare, urban development, education and interests. Property taxes, municipal license taxes, sales taxes, and state and federal grants finance most of these activities.

**FUND FINANCIAL STATEMENTS**

The Municipality's fund financial statements consist of: (1) the balance sheet and (2) the statement of revenues, expenditures and changes in fund balances. These financial statements report the financial position and the results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major governmental funds.

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

**GOVERNMENTAL FUNDS**

The Municipality's basic services are reported in the government fund financial statements. The government funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted into cash. 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. Such information may be useful in evaluating a government's near-term financing requirements. 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, readers may better understand the long-term impact of the government's near-term financing decisions.

The Municipality adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**OTHER INFORMATION**

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information containing budget to actual comparisons for the general and major funds.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

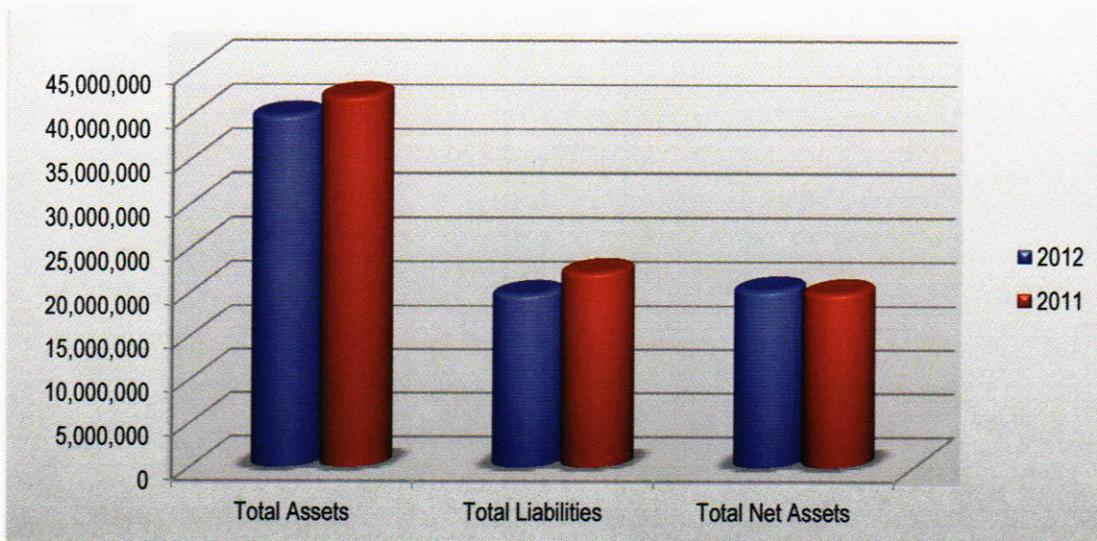
**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**GOVERNMENT-WIDE FINANCIAL ANALYSIS**

**GOVERNMENTAL NET ASSETS**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Municipality, assets exceeded liabilities by \$20,204,087 as of June 30, 2012, versus \$19,903,239 as of June 30, 2011, as restated. Our analysis below focuses on the net assets (**Table 1**) and changes in net assets of the Municipality's governmental activities.

<b>Table 1</b> <b>Statement of Net Assets</b>	<b>2012</b>	<b>2011</b> <b>(as restated)</b>
Current and non-current assets	\$ 5,119,359	\$ 9,416,730
Capital assets	<u>34,812,853</u>	<u>32,706,579</u>
<b>Total Assets</b>	<b><u>39,932,212</u></b>	<b><u>42,123,309</u></b>
Current liabilities	1,905,666	3,650,029
Long-term liabilities	<u>17,822,459</u>	<u>18,570,041</u>
<b>Total Liabilities</b>	<b><u>19,728,125</u></b>	<b><u>22,220,070</u></b>
Net assets:		
Investment in capital assets, net of related debt	24,991,051	22,563,801
Restricted	3,852,680	5,630,212
Deficit	<u>(8,639,644)</u>	<u>(8,290,774)</u>
<b>Total Net Assets</b>	<b><u>\$ 20,204,087</u></b>	<b><u>\$ 19,903,239</u></b>



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)**

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g. land, buildings, machinery and equipment), less any related debt used to acquire those assets still outstanding. These capital assets are used to provide services to citizens; consequently these assets are not available for future spending. It should also be noted that the resources required to repay the related debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. An additional portion of the Municipality's net assets represents resources that are subject to external restrictions on how they may be used.

**GOVERNMENTAL ACTIVITIES**

Governmental activities decreased the Municipality's net assets. Key elements of this decrease are as follows: the Municipality's governmental activities had net expenses of \$(10,021,545). However, these services are intended to be primarily funded by taxes, as opposed to charges for services and grants, and those taxes and other general revenues exceed net expenses by \$300,848.

The cost of all governmental activities this year was \$13,943,748. **Table 2** presents the cost of each of the Municipality's largest programs.

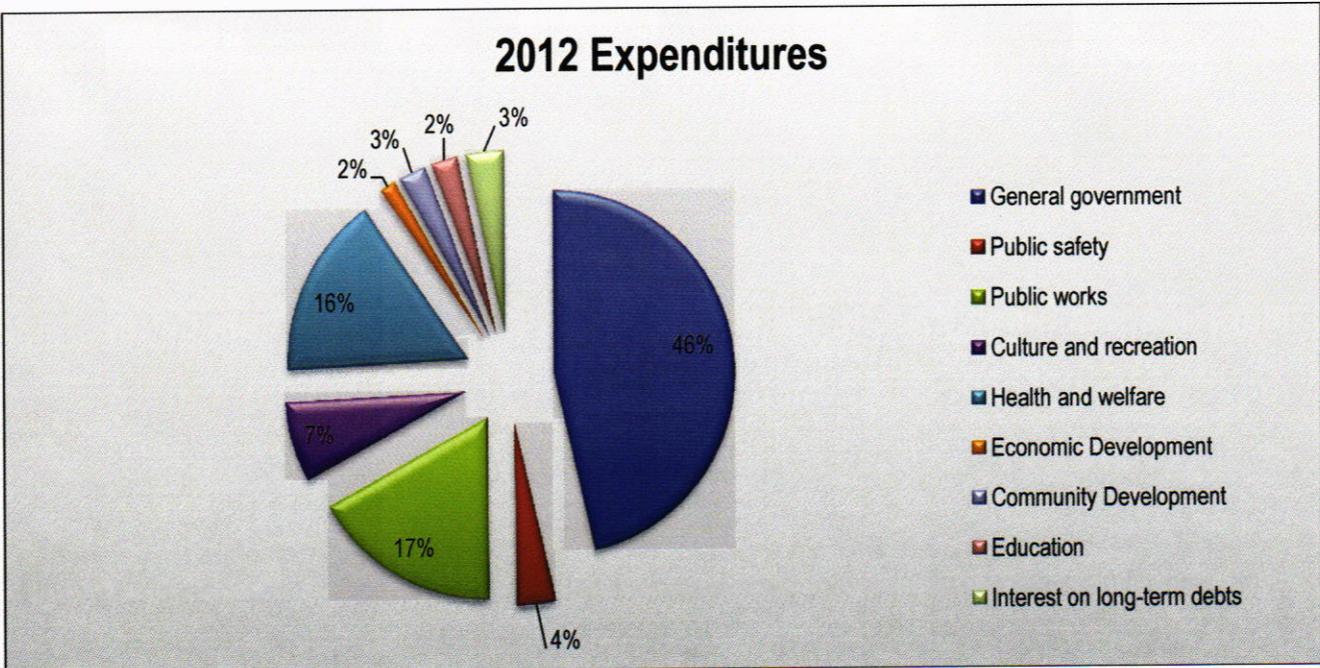
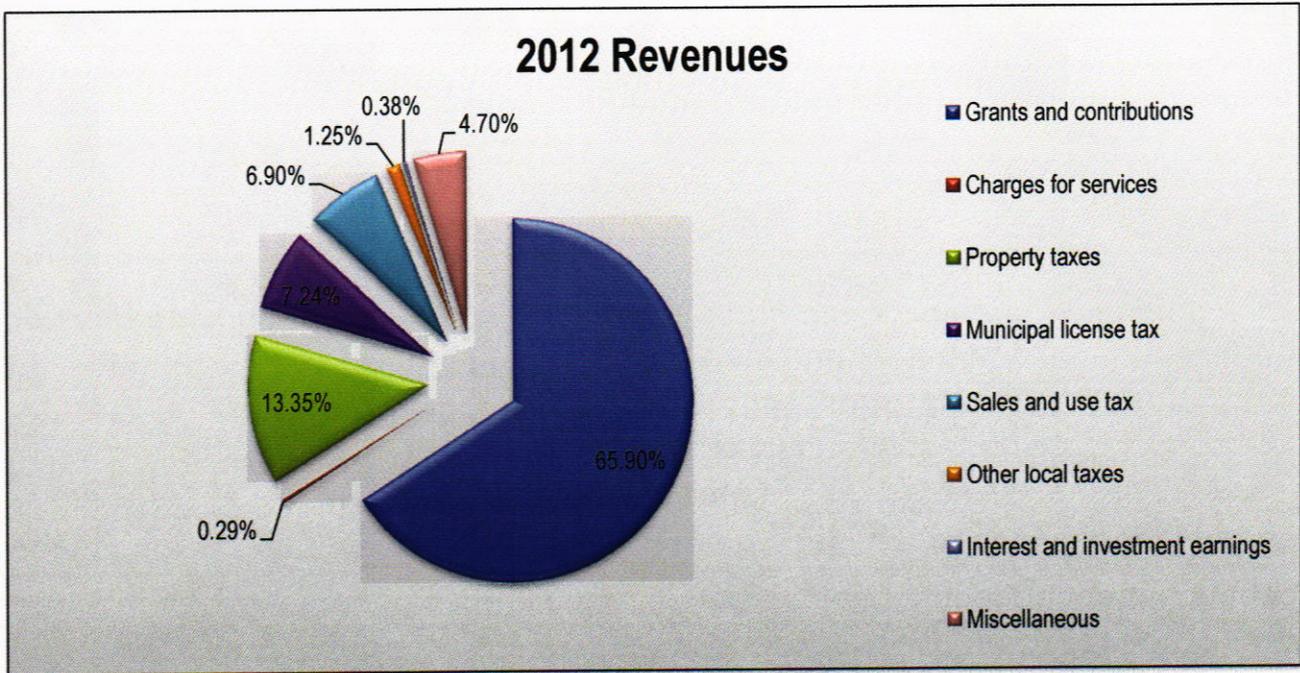
<u>Table 2</u> <u>Statement of Activities</u>	<u>2012</u>	<u>2011</u> <u>(as restated)</u>
Revenues		
Program revenues:		
Grants and contributions	\$ 9,386,911	\$ 9,456,390
Charge for services	40,716	51,206
General revenues:		
Property taxes	1,901,512	1,941,833
Municipal license taxes	1,030,876	899,824
Sales and use taxes	983,287	969,580
Other local taxes	177,741	716,968
Interest and investment earnings	53,943	114,303
Other revenues	669,610	118,176
Total revenues	<u>14,244,596</u>	<u>14,268,280</u>
Expenses		
General government	6,468,594	5,462,593
Public safety	490,087	615,753
Public works	2,381,628	2,556,428
Culture and recreation	1,004,355	2,010,938
Health and welfare	2,247,100	2,650,798
Economic Development	200,713	580,969
Community Development	345,525	560,480
Education	333,615	44,115
Interest on long-term debts	472,131	412,558
Total expenses	<u>13,943,748</u>	<u>14,894,632</u>
Changes in net assets	300,848	(626,352)
Net assets – beginning, as restated	<u>19,903,239</u>	<u>20,529,591</u>
<b>Net assets – ending</b>	<b><u>\$ 20,204,087</u></b>	<b><u>\$ 19,903,239</u></b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)**

Approximately Twenty-eight percent (28%) of the Municipality's governmental activities total revenue came from taxes, while sixty-six percent (66%) resulted from grants and contributions. Federal grants represent thirty-two percent (32%) of the Municipality grants revenues.

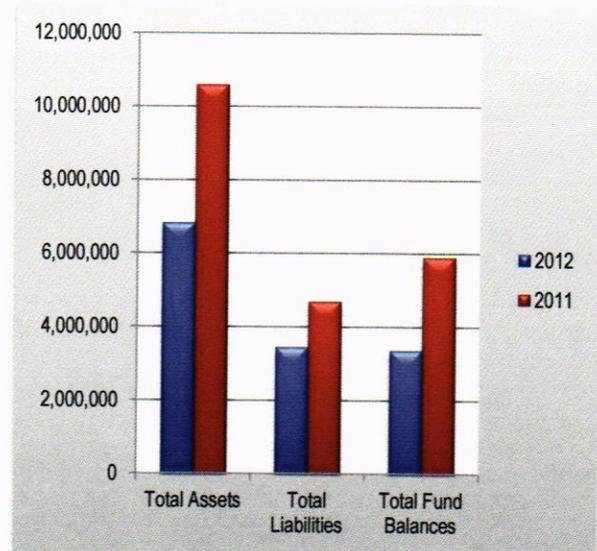
The Municipality's governmental activities expenses included items such as general government, public safety, public works, culture and recreation, health and welfare, economic development, community development, education and interest on long term debts. Approximately forty-six percent (46%) of total expenses resulted from general government, seventeen percent (17%) from public works, seven percent (7%) from culture and recreation and sixteen (16%) from health and welfare.

**GOVERNMENT FUND FINANCIAL ANALYSIS**

As noted earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Table 3**  
**Balance Sheet**

	<b>2012</b>	<b>2011 (as restated)</b>
<b>Assets:</b>		
Total assets – Major Funds	\$ 5,159,476	\$ 8,587,266
Total assets – Other Funds	1,681,576	2,005,804
<b>Total assets</b>	<b>\$ 6,841,052</b>	<b>\$ 10,593,070</b>
<b>Liabilities:</b>		
Total liabilities – Major Funds	\$ 3,153,170	\$ 4,197,357
Total liabilities – Other Funds	308,472	501,566
Combined total liabilities	3,461,642	4,698,923
<b>Fund Balances:</b>		
Restricted	3,852,680	5,642,865
Assigned	-	112,212
Unassigned	(473,270)	139,070
Combined total fund balances	3,379,410	5,894,147
<b>Total liabilities and fund balances</b>	<b>\$ 6,841,052</b>	<b>\$ 10,593,070</b>



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

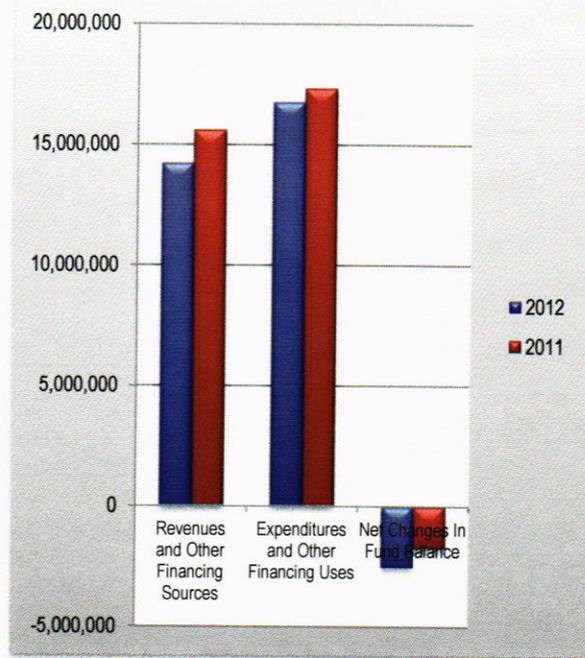
**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**GOVERNMENT FUND FINANCIAL ANALYSIS (CONTINUED)**

**Table 4**

**Changes in Fund Balances**

	<u>2012</u>	<u>2011</u> <u>(as restated)</u>
<b>Revenues:</b>		
Total revenues – Major Funds	\$ 12,569,124	\$ 12,052,231
Total revenues – Other Funds	<u>1,675,472</u>	<u>2,216,049</u>
Combined total revenues	<u>14,244,596</u>	<u>14,268,280</u>
<b>Expenditures:</b>		
Total expenditures – Major Funds	14,946,913	15,166,538
Total expenditures – Other Funds	<u>1,812,420</u>	<u>2,164,100</u>
Combined total expenditures	<u>16,759,333</u>	<u>17,330,638</u>
<b>Other financing sources (uses):</b>		
Other financing sources – Major Funds	(5,814)	1,345,000
Other financing sources – Other Funds	<u>5,814</u>	<u>-</u>
Combined other financing sources (uses)	<u>-</u>	<u>1,345,000</u>
Net changes in fund balance	(2,514,737)	(1,717,358)
Fund Balance – beginning, as restated	<u>5,894,147</u>	<u>7,611,505</u>
Fund Balance – ending	<u>\$ 3,379,410</u>	<u>\$ 5,894,147</u>



**GOVERNMENTAL FUNDS**

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

At June 30, 2012, the Municipality's governmental funds reported combined ending fund balances of \$3,379,410, a decrease of \$(2,514,737) from the prior year.

The Municipality has an unassigned fund deficit of (\$473,270) in its General Fund. The remainder of the balance is reserved to indicate that it is not available for new spending because it has already been restricted to pay debt service (\$2,396,525) and for other restricted purposes (\$1,456,155).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**BUDGETARY HIGHLIGHTS**

Budget and actual comparison schedules are provided in the Basic Financial Statements for the General Fund. The Budgetary Comparison Schedule of the General Fund shows the original adopted budgets, the final revised budget, actual results, and variance between the final budget and actual results for the general and major special revenue funds. **Table 5** summarizes the results of the General Fund's Budgetary Comparison Schedule:

<b>Table 5</b>	<b>Final Budget</b>	<b>Actual Amounts</b>	<b>Variance</b>
Total revenues	\$ 9,828,484	\$ 9,312,738	\$ (515,746)
Total expenditures, encumbrances and other financing uses	<u>9,828,484</u>	<u>10,454,485</u>	<u>(626,001)</u>
<b>Excess or deficiency</b>	<b>\$ -</b>	<b><u>\$(1,141,747)</u></b>	<b><u>\$(1,141,747)</u></b>

The original and the final budget of the General Fund for the fiscal year ended June 30, 2012 amounted to \$ 9,828,484. The laws and regulations of the Commonwealth mandate a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$9,312,738, which is (\$515,746) less than the budgeted revenues. In addition, the total actual expenditures and other financing sources (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$10,454,485, which is \$626,001 more than the budgeted expenditures.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

The Municipality's investment in capital assets for its governmental type activities as of June 30, 2012 amounted to \$34,812,853 (net of accumulated depreciation). This investment in capital assets includes land, constructions in progress, works of art, buildings, buildings improvements, infrastructure, infrastructure improvements, equipment, furnishing, computers and vehicles. The total increase in the Municipality's investment in capital assets for the current fiscal year was \$3,365,048. **Table 6** present the major classes of capital assets.

<b>Table 6 Capital Assets</b>	<b>Amount</b>
Land	\$ 9,705,674
Land – Housing Project	595,000
Construction in progress	1,518,524
Buildings and improvements	15,215,063
Infrastructure and improvements	6,829,055
Equipment	202,664
Buildings and improvements – furnishings and equipment – Housing Project	673,066
Others	<u>73,807</u>
<b>Total Assets</b>	<b><u>\$ 34,812,853</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**LONG-TERM DEBT**

At June 30, 2012, the Municipality had total of \$17,822,459 in general obligations and others outstanding debts, as shown in Table 7:

<b>Table 7</b>	
<b>Long Term Debts</b>	<b>Amount</b>
Bonds and notes payable	\$ 10,496,000
Section 515 direct loan	1,825,802
Others	<u>5,500,657</u>
<b>Total Long Term Debts</b>	<b><u>\$ 17,822,459</u></b>

The Municipality is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the Municipality in order for the bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leave and advances of property taxes. More detailed information about the Municipality's long-term liabilities is presented in the notes to the financial statements. The Municipality continues to meet its financial needs through prudent use of its revenues and creative debt financing programs.

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

Local, national and international economic factors influence the Municipality's revenues. Positive economic growth is correlated with increased revenues from property taxes, municipal license taxes, sales taxes, charges for services, as well as state and federal grants. Economic growth in the local economy may be measured by a variety of indicators such as employment growth, unemployment, new construction, assessed valuation, and other revenues.

All of these factors were considered in preparing the Municipality's budget for the 2012 fiscal year. Some cost reductions helped fund improvements of existing facilities, public safety and works, economic development initiatives and human service improvements.

**OTHER COMMENTS**

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

**REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information contact the Municipality's Finance Department at (787) 839-3500.

**Commonwealth of Puerto Rico**  
**Municipality of Arroyo**  
**Statement of Net Assets**  
**June 30, 2012**

	<b>Governmental Activities</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 1,378,387
Cash with fiscal agent	3,135,237
Accounts receivable:	
Municipal license taxes	22,622
Municipal sales and use taxes	59,794
Intergovernmental	517,834
Other assets	5,485
Capital assets	
Land, improvements, and construction in progress	11,822,608
Other capital assets, net of depreciation	22,990,245
Total capital assets	34,812,853
<b>Total assets</b>	<b>39,932,212</b>
<b>Liabilities</b>	
Accounts payable and accrued liabilities	551,446
Due to other governmental entities	201,482
Deferred revenues:	
Municipal license tax	890,881
Federal grant revenues	96,140
Interest payable	165,717
Noncurrent liabilities:	
Due within one year	784,415
Due in more than one year	17,038,044
<b>Total liabilities</b>	<b>19,728,125</b>
<b>Net Assets</b>	
Invested in capital assets, net of related debt	24,991,051
Restricted for:	
Debt service	2,396,525
Other purposes	1,456,155
Unrestricted (deficit)	(8,639,644)
<b>Total net assets</b>	<b>\$ 20,204,087</b>

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

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

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 6,468,594	\$ -	\$ -	\$ -	\$ (6,468,594)
Public safety	490,087		115,126		(374,961)
Public works	2,381,628		1,050,072	60,579	(1,270,977)
Health and welfare	2,247,100	35,812	1,472,165		(739,123)
Culture and recreation	1,004,355				(1,004,355)
Economic development	200,713		200,713		-
Community development	345,525			653,102	307,577
Education	333,615	4,904	329,730		1,019
Interest on long-term debt	472,131				(472,131)
<b>Total governmental activities</b>	<b>\$ 13,943,748</b>	<b>\$ 40,716</b>	<b>\$ 3,167,806</b>	<b>\$ 713,681</b>	<b>\$ (10,021,545)</b>
General revenues:					
Property taxes					1,901,512
Municipal license taxes					1,030,876
Municipal sales and use taxes					983,287
Other local taxes					177,741
Grants and contributions not restricted to specific programs					5,505,424
Interest and investment earnings					53,943
Miscellaneous					669,610
<b>Total general revenues</b>					<b>10,322,393</b>
Change in net assets					300,848
Net assets - beginning-as restated					19,903,239
Net assets - ending					<b>\$ 20,204,087</b>

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

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

	<u>General Fund</u>	<u>Special Revenue Fund - Federal Grants</u>	<u>Capital Projects Fund - State &amp; Local Grants</u>	<u>Debt Service Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>Assets</b>						
Cash and cash equivalents	\$ 154,524	\$ 200,349	\$ -	\$ -	\$ 1,023,514	\$ 1,378,387
Cash with fiscal agent	83,051	53,108	608,571	2,390,507		3,135,237
Accounts receivable:						
Municipal license taxes	22,622					22,622
Municipal sales and use taxes	59,794					59,794
Intergovernmental	117,558	236,130	5,759	6,018	152,369	517,834
Due from other funds	916,485		305,000		500,208	1,721,693
Other assets					5,485	5,485
<b>Total assets</b>	<u>\$ 1,354,034</u>	<u>\$ 489,587</u>	<u>\$ 919,330</u>	<u>\$ 2,396,525</u>	<u>\$ 1,681,576</u>	<u>\$ 6,841,052</u>
<b>Liabilities and Fund Balances</b>						
Liabilities :						
Accounts payable and accrued liabilities	\$ 340,690	\$ 150,635	\$ -	\$ -	\$ 60,121	\$ 551,446
Due to other governmental entities	201,482					201,482
Due to other funds	311,200	242,812	919,330		248,351	1,721,693
Deferred revenues:						
Municipal license tax	890,881					890,881
Federal grant revenues		96,140				96,140
<b>Total liabilities</b>	<u>1,744,253</u>	<u>489,587</u>	<u>919,330</u>	<u>-</u>	<u>308,472</u>	<u>3,461,642</u>
Fund balances:						
Restricted	83,051			2,396,525	1,373,104	3,852,680
Unassigned	(473,270)					(473,270)
<b>Total fund balances (deficit)</b>	<u>(390,219)</u>	<u>-</u>	<u>-</u>	<u>2,396,525</u>	<u>1,373,104</u>	<u>3,379,410</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,354,034</u>	<u>\$ 489,587</u>	<u>\$ 919,330</u>	<u>\$ 2,396,525</u>	<u>\$ 1,681,576</u>	<u>\$ 6,841,052</u>

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

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

	General Fund	Special Revenue Fund Federal Grants	Capital Projects Fund - State & Local Grants	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
<b>Revenues</b>						
Property taxes	\$ 1,413,917	\$ -	\$ -	\$ 487,595	\$ -	\$ 1,901,512
Municipal license taxes	1,030,876					1,030,876
Municipal sales and use taxes	605,698			377,589		983,287
Licenses, permits and other local taxes	177,741					177,741
Intergovernmental	5,505,424		65,848		271,576	5,842,848
Fines and forfeitures	1,569					1,569
Rent of property	58,113				491,572	549,685
Interest	53,943					53,943
Federal grants		2,180,393			861,676	3,042,069
Miscellaneous	609,928		490		50,648	661,066
<b>Total revenues</b>	<b>9,457,209</b>	<b>2,180,393</b>	<b>66,338</b>	<b>865,184</b>	<b>1,675,472</b>	<b>14,244,596</b>
<b>Expenditures</b>						
Current:						
General government	6,506,919					6,506,919
Public safety	438,941	43,408			34,365	516,714
Public works	2,324,952	539,193	2,007,707			4,871,852
Health and welfare	669,763	118,917			1,383,734	2,172,414
Culture and recreation	578,087				11,080	589,167
Economic development					200,713	200,713
Community development		653,102				653,102
Education		329,730				333,615
Debt service:						
Principal				436,000	44,976	480,976
Interest				300,194	133,667	433,861
<b>Total expenditures</b>	<b>10,518,662</b>	<b>1,684,350</b>	<b>2,007,707</b>	<b>736,194</b>	<b>1,812,420</b>	<b>16,759,333</b>
Excess (deficiency) of revenues over (under) expenditures	(1,061,453)	496,043	(1,941,369)	128,990	(136,948)	(2,514,737)
<b>Other financing sources (uses)</b>						
Transfers in	504,643			109,765	14,414	628,822
Transfers out	(124,179)	(496,043)			(8,600)	(628,822)
<b>Total other financing sources (uses)</b>	<b>380,464</b>	<b>(496,043)</b>	<b>-</b>	<b>109,765</b>	<b>5,814</b>	<b>-</b>
Net change in fund balances	(680,989)		(1,941,369)	238,755	(131,134)	(2,514,737)
Fund balance, beginning-as restated	290,770		1,941,369	2,157,770	1,504,238	5,894,147
Fund balance (deficit), ending	\$ (390,219)	\$ -	\$ -	\$ 2,396,525	1,373,104	\$ 3,379,410

*Arroyo*  
*03/24/2013*

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**RECONCILIATION OF THE BALANCE SHEET- GOVERNMENTAL FUNDS  
TO THE STATEMENT OF NET ASSETS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**Total Fund Balances – Governmental Funds (Page 15)..... \$ 3,379,410**

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.....	\$ 11,822,608	
Depreciable Capital Assets .....	41,814,873	
Accumulated Depreciation.....	<u>(18,824,628)</u>	
Total Capital Assets .....		34,812,853

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 .....	10,496,000	
Section 515 Direct Loan .....	1,825,802	
Compensated Absences .....	1,103,046	
Claims and Judgments .....	153,422	
Property Tax Debt – Law 42.....	2,062,329	
Property Tax Debt – Law 146.....	487,798	
Landfill Obligation.....	<u>1,694,062</u>	
Total Long-Term Liabilities .....		(17,822,459)

Interest liabilities not due and payable in the current period and, therefore, are not reported in the funds ..... (165,717)

**Total Net Assets of Governmental Activities (Page 13)..... \$ 20,204,087**

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**Net Change in Fund Balances – Total Governmental Funds (Page 16)..... \$ (2,514,737)**

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

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:

Capital Assets Additions .....	3,365,048	
Depreciation Expense .....	<u>(1,258,774)</u>	
Excess of Capital Assets Additions over Depreciation Expense.....		2,106,274

Repayments of long-term bonds, notes and other loans principal are expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current period, these repayments are:

Bonds and Notes .....	436,000	
Section 515 Direct Loan .....	<u>44,976</u>	
Total Payments .....		480,976

Repayments of other long-term debts principal are expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. The following amount represented the change in these debts from prior year:

Decrease in Compensated Absences .....	159,042	
Increase in Claims and Judgments .....	(32,000)	
Decrease in Property Tax Debt – Law 42 .....	51,164	
Decrease in Property Tax Debt – Law 146 .....	24,390	
Increase in Landfill Obligation .....	(34,787)	
Decrease in LIMS Repayment Plan .....	16,201	
Decrease in Property Tax 2009-2010 Settlement .....	75,595	
Decrease in Puerto Rico Aqueduct and Sewer Authority Debt .....	7,000	
Total Additional Expenditures .....		266,605

Certain interest cost reported in the Statement of Activities do not require the use of current financial resources and, therefore are not reported as expenditures in the governmental funds. The following amount represented the change in accrued interest from prior year.

(38,270)

**Change in Net Assets of Governmental Activities (Page 14) ..... \$ 300,848**

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The **Municipality of Arroyo, Puerto Rico (Municipality)** was founded in the year 1855, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of twelve Legislators also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the Municipality conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant policies.

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

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASBS No. 34, No. 37 and No. 38. They require new information and restructure much of the information that governments have presented in the past.

The accompanying basic financial statements present the financial position and the results of operations of the Municipality and its various funds and fund types. The basic financial statements are presented as of June 30, 2012, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

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

**A. Financial Reporting Entity**

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 GASB Statement No. 39. 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**A. Financial Reporting Entity (Continued)**

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. GAAP 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.

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Based on the above criteria, the financial statements of Brisas de Arroyo Housing Project no. 565039950 were included in the general-purpose financial statements as a blended component unit.

**Blended Component Unit:** Brisas de Arroyo Housing Project is a housing development consisting of one hundred four (104) dwelling units located in Arroyo, Puerto Rico. The Project is owned by the Municipality, but the activities on it are carried-on by a management agent unrelated to the Municipality. The housing development is designated to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The Project operated under financing from US Department of Agriculture Section 515 Rural Rental Housing Loans Program, and with a Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with US Housing and Urban Development. For financial reporting purposes, the Housing Project is reported as if it were part of the Municipality's operations because its purpose is to provide low-income housing to citizens of the Municipality. The Financial Statements of the blended component unit can be obtained directly from the Municipality's Chief Financial Officer at PO Box 477, Arroyo, Puerto Rico 00714-0477, or call (787) 839-2030.

**B. Measurement Focus and Basis of Accounting**

**Government-Wide Financial Statements**

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

**Governmental Fund Financial Statements**

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**B. Measurement Focus and Basis of Accounting (Continued)**

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For some grants, funds must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- ❖ Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2012, has been reported only in the government-wide financial statements.

**C. Financial Statement Presentation**

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

**Government-Wide Financial Statements**

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) report information of all the activities of the Municipality. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The focus of the Statement of Net Assets is designed to be similar to bottom line results for the Municipality and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term expendable resources) with capital assets and long-term obligations.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**C. Financial Statement Presentation (Continued)**

The Statement of Net Assets presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- ❖ **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- ❖ **Restricted Net Assets** – These results when constraints are placed on net assets use, which can be either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- ❖ **Unrestricted Net Assets** – These consists of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is the Municipality's policy to use restricted resources first, then the unrestricted resources as they are needed.

The Statement of Activities is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

**Governmental Fund Financial Statements**

The fund financial statements (the Balance Sheet and the Statement of Revenues, Expenditures, and Changes in Fund Balances) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in a different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and a separate explanation for each differences.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**C. Financial Statement Presentation (Continued)**

The Municipality reports its financial position (Balance Sheet) and results of operations (Statement of Revenues, Expenditures and Changes in Fund Balance) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

The new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major fund:

**General Fund** – is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

**Special Revenue Fund – Federal Grants** – is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Capital Projects Fund – State & Local Grants** – is the accounting entity in which revenues derived from local funds, state grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital projects fund are specified by Municipality ordinances or state statutes.

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

GASBS No. 34 eliminates the presentation of Account Groups, but provides for these records to be maintained and incorporates the information into the Governmental column in the Government-Wide Statement of Net Assets.

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**C. Financial Statement Presentation (Continued)**

**Special Revenue Fund – Section 8 Programs** – Special Revenue Funds are used to account for revenues derived from section 8 choice voucher program and from section 8 moderate rehabilitation program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Special Revenue Fund – Housing Project** – Special Revenue Funds are used to account for revenues derived from the blended component unit activities. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

**Special Revenue Fund – 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 Fund – State and Local Grants** – Capital Projects Fund are used to account for financial resources used for the acquisition or construction of major capital facilities.

**Capital Projects Fund – Federal Grants** – This is the fund used to account for revenues derived from federal grants related to capital projects. The uses and limitations of each capital projects fund are specified by Municipality ordinances or federal and state statutes.

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

**D. Budgetary Data**

The Municipality annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts of Proprietary Funds and Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of supplemental appropriations. During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**D. Budgetary Data (Continued)**

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

1. Prior to May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to continue making payments for its operating and other expenses until the new budget is approved.
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP.
3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**D. Budgetary Data (Continued)**

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

**E. Cash, Cash Equivalent and Investment**

The Director of Finance of the Municipality is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

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

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico. The sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

**F. Receivables**

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

**G. Inventories**

The General, Special Revenue and Capital Projects Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements.

**H. Capital Assets**

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The Municipality's capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. Other costs incurred for repairs and maintenance is expensed as incurred.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**H. Capital Assets (Continued)**

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

<b>Capital Assets</b>	<b>Years</b>
Buildings and site improvements	40
Infrastructure	40
Motor vehicles, furniture and fixtures	5
Machinery and equipments	3-5

**I. Long-Term Obligations**

The liabilities reported in the government-wide financial statements included 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.

**J. Compensated Absences**

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Municipality accrued a liability for compensated absences, which meet the following criteria:

1. The Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**J. Compensated Absences (Continued)**

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2012.

<u>BALANCE JULY 1, 2011</u>	<u>NEW ISSUES</u>	<u>RETIREMENTS AND CURRENT MATURATES</u>	<u>BALANCE JUNE 30, 2012</u>	<u>CURRENT PORTION</u>	<u>LONG-TERM PORTION</u>
\$ 1,262,088	\$ -	\$ 159,042	\$ 1,103,046	\$ 190,844	\$ 912,202

**K. Insurance**

The Municipality has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the Municipality are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy sent to the Municipality.

**L. Interfund Transactions**

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The Municipality has the following types of reciprocal and nonreciprocal interfund activities:

- ❖ **Interfund loans** – Represent amounts provided with a requirement for repayment, which are recorded as "due from" in the lender governmental fund and "due to" in the borrower governmental fund. Interfund receivables, which are not considered currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period, interfund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as a transfer from the governmental fund that made the loan.
- ❖ **Interfund transfers** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as other financing uses in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.
- ❖ **Interfund reimbursements** – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

**M. Reservations of Fund Balance – Governmental Funds**

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

COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

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

- ❖ **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.
- ❖ **Unassigned** – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

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

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

**N. Claims and Judgments**

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

**O. Use of Estimates**

The preparation of the basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported revenue and expenses during the reporting period. Actual result could differ from those estimates.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**P. Accounting for Pension Costs**

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

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

**Q. 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 Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2012 amounted to \$213,244. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$203,920 for workers compensation insurance covering all municipal employees.

**R. Future Adoption of Accounting Pronouncements**

The GASB has issued the following standards that have effective dates after June 30, 2012:

- ❖ GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (GASB No. 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.
- ❖ 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 requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**R. Future Adoption of Accounting Pronouncements (Continued)**

- ❖ 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 Board Opinions, 3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. This Statement is effective for periods beginning after December 15, 2011.
- ❖ GASB Statement No. 63 *Financial Reporting of 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 those 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.
- ❖ GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this Statement is to establish 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 the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination 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.
- ❖ 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.

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

**NOTE 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 2 – CASH AND CASH EQUIVALENTS (CONTINUED)**

**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.

**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.

The Municipality's bank balances in commercial banks of \$154,524 in the general fund and \$200,349 in the special revenue fund – federal grants were fully collateralized at June 30, 2012. In the other governmental funds there were deposits with commercial banks of \$1,023,514 that were fully collateralized.

The deposits at GDB of \$83,051 in the general fund, the \$53,108 in the special revenue fund – federal grants, the \$608,571 in the capital projects fund – state and local grants, and the \$2,390,507 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**NOTE 3 – RECEIVABLES**

**A. Municipal License Taxes**

As described below in Note 13, municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2012, net of allowance for uncollectible. Therefore, municipal license tax receivable of \$22,622 in the general fund represents the amount due by the taxpayers at June 30, 2012.

**B. Municipal Sales and Use Taxes Receivable**

As described below in Note 14, the Municipal Legislature approved the imposition of the municipal sales and use tax during fiscal year 2006-2007. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 20<sup>th</sup> day of each month based on tax collected in the preceding month. Therefore, sales tax receivable of \$59,794 in the general fund represents the amount due by the taxpayers at June 30, 2012.

**C. Intergovernmental Receivables**

As described below in Note 12, 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. Therefore, intergovernmental receivable of \$117,558 in the general fund represents the amounts due from the CRIM resulting from the excess of current year property tax collections over current year advances.

Intergovernmental receivable in the special revenue fund – federal grants represent expenditures incurred not yet reimbursed by the federal agencies or the pass-through grantors. Following is a detail of the intergovernmental receivable:

<u>Program Description</u>	<u>Amount</u>
Community Development Block Grant – State's Program	\$ 74,615
Child Care and Development Block Grant	156,104
Others	<u>5,411</u>
<b>Total</b>	<b><u>\$ 236,130</u></b>

Intergovernmental receivable of \$152,369 in other governmental funds represent Law 52 proposal expenditures incurred not yet reimbursed by the Commonwealth of Puerto Rico – Department of Labor and Human Resources.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

**NOTE 4 – INTERFUND TRANSFER AND BALANCES**

**A. INTERFUND RECEIVABLES – DUE FROM / TO OTHER FUNDS**

Interfund receivables and payables at June 30, 2012 are summarized as follows:

Receivable Fund	Payable Fund	Purpose	Amount
General Fund	Special Revenue Fund– Federal Grants	Payroll and related accruals paid and not reimbursed, and other reimbursable expenditures	\$ 242,812
General Fund	Capital Projects Fund– State and Local Grants	Construction projects contracts incurred as loans by operational funds, and not reimbursed by the special funds	425,322
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	248,351
Capital Projects Fund– State and Local Grants	General Fund	Operational loans not reimbursed to special funds at the end of the fiscal year	305,000
Other Governmental Funds	General Fund	Operational loans not reimbursed to special funds at the end of the fiscal year	6,200
Other Governmental Funds	Capital Projects Fund– State and Local Grants	Cash pool in the same bank account	<u>494,008</u>
<b>Total</b>			<b><u>\$ 1,721,693</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 5 – CAPITAL ASSETS**

Capital assets; those with an estimated useful live 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

<b>Governmental Activities</b>	<b>Balance July 1, 2011 (as restated)</b>	<b>Additions</b>	<b>Retirements / Reclassifications</b>	<b>Balance June 30, 2012</b>
Capital asset, not being depreciated:				
Land	\$ 9,705,674	\$ -	\$ -	\$ 9,705,674
Land – Housing Project	595,000			595,000
Work of Art	3,410			3,410
Construction in progress	<u>5,867,869</u>	<u>1,620,976</u>	<u>(5,970,321)</u>	<u>1,518,524</u>
<b>Total capital assets not being depreciated</b>	<u>16,171,953</u>	<u>1,620,976</u>	<u>(5,970,321)</u>	<u>11,822,608</u>
Capital assets, being depreciated:				
Buildings	15,981,597	2,751,343		18,732,940
Building improvements	3,535,001	1,921,667		5,456,668
Infrastructure	5,636,844	101,709		5,738,553
Infrastructure improvements	1,705,183	2,794,828		4,500,011
Equipment	891,166	121,872		1,013,038
Furnishing	316,836			316,836
Computers	92,556			92,556
Vehicles	2,256,606			2,256,606
Buildings and improvements – furnishings and equipment – Housing Project	<u>3,684,691</u>	<u>22,974</u>	<u>-</u>	<u>3,707,665</u>
<b>Total capital assets being depreciated</b>	<u>34,100,480</u>	<u>7,714,393</u>	<u>-</u>	<u>41,814,873</u>
Less accumulated depreciation for:				
Buildings	(8,038,502)	(466,949)		(8,505,451)
Building improvements	(332,677)	(136,417)		(469,094)
Infrastructure	(2,495,394)	(88,602)		(2,583,996)
Infrastructure improvements	(525,512)	(300,001)		(825,513)
Equipment	(717,244)	(93,130)		(810,374)
Furnishing	(313,080)	(3,350)		(316,430)
Computers	(91,961)	(595)		(92,556)
Vehicles	(2,114,374)	(72,241)		(2,186,615)
Buildings and improvements – furnishings and equipment – Housing Project	<u>(2,937,110)</u>	<u>(97,489)</u>	<u>-</u>	<u>(3,034,599)</u>
<b>Total accumulated depreciation</b>	<u>(17,565,854)</u>	<u>(1,258,774)</u>	<u>-</u>	<u>(18,824,628)</u>
<b>Total capital assets being depreciated, net</b>	<u>16,534,626</u>	<u>6,455,619</u>	<u>-</u>	<u>22,990,245</u>
<b>Governmental activities capital assets, net</b>	<u><b>\$ 32,706,579</b></u>	<u><b>\$ 8,076,595</b></u>	<u><b>\$ (5,970,321)</b></u>	<u><b>\$ 34,812,853</b></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 5 – CAPITAL ASSETS (CONTINUED)**

Depreciation expenses were charged to governmental functions/programs as follows:

<b>Governmental activities</b>	<b>Amount</b>
General Government	\$ 263,067
Public Safety	95,245
Public Works	348,319
Community Development	39,295
Health and Welfare	97,660
Culture and Recreation	415,188
<b>Total depreciation expenses</b>	<b><u>\$ 1,258,774</u></b>

**NOTE 6 – ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities in governmental fund financial statements represent expenditures incurred during fiscal year 2011-2012, and not paid by the Municipality at June 30, 2012. Following is a detail of these accounts payable and accrued liabilities:

<b>Major Governmental Funds</b>	<b>Accounts Payable</b>	<b>Accrued Liabilities</b>	<b>Total</b>
General Fund	\$ 186,564	\$ 154,126	\$ 340,690
Special Revenue Fund – Federal Grants	150,635		150,635
Other Governmental Funds	60,121	-	60,121
<b>Total</b>	<b><u>\$ 397,320</u></b>	<b><u>\$ 154,126</u></b>	<b><u>\$ 551,446</u></b>

**NOTE 7 – DUE TO OTHER GOVERNMENTAL UNITS**

As of June 30, 2012, balance due to other governmental units consists of the following:

<b>Governmental Agency</b>	<b>Amount</b>
Puerto Rico Aqueduct and Sewer Authority	\$ 179,860
General Service Administration	12,430
Municipal Revenue Collection Center	587
Commonwealth of Puerto Rico-Department of Labor and Human Resources	8,605
<b>Total</b>	<b><u>\$ 201,482</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 8 – DEFERRED REVENUES**

- A. Municipal License Tax** – The deferred revenues of \$890,881 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 Government** – The deferred revenues presented in the special revenue fund – federal grants represents 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>
Disaster Grants – Public Assistance	\$ 78,417
Others	<u>17,723</u>
<b>Total</b>	<b><u>\$ 96,140</u></b>

**NOTE 9 – GENERAL LONG-TERM DEBTS**

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	\$ 5,865,000	\$ -	\$ (190,000)	\$ 5,675,000	\$ 200,000
Notes Payable	5,067,000		(246,000)	4,821,000	266,000
Section 515 direct loan	1,870,778		(44,976)	1,825,802	48,803
Compensated absences	1,262,088		(159,042)	1,103,046	190,844
Claims and judgments	121,422	132,000	(100,000)	153,422	
Property Tax Debt – Law 42	2,113,493		(51,164)	2,062,329	54,378
Property Tax Debt – Law 46	512,188		(24,390)	487,798	24,390
Property Tax Debt – Final Liquidation	75,595		(75,595)		
Landfill obligation	1,659,275	34,787		1,694,062	
LIMS Repayment Plan	16,201		(16,201)		
Puerto Rico Aqueduct and Sewer Authority	<u>7,000</u>	<u>-</u>	<u>(7,000)</u>	<u>-</u>	<u>-</u>
<b>Total</b>	<b><u>\$ 18,570,040</u></b>	<b><u>\$ 166,787</u></b>	<b><u>\$ (914,368)</u></b>	<b><u>\$ 17,822,459</u></b>	<b><u>\$ 784,415</u></b>

**A. LEGAL DEBT MARGIN**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 9 – GENERAL LONG-TERM DEBTS (CONTINUED)**

**B. GENERAL OBLIGATIONS BONDS**

The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. General obligations bonds as of June 30, 2012, are comprised of the following individual issues:

<b>DESCRIPTION</b>	<b>AMOUNT</b>
\$1,410,000 Series 2002, for construction purposes, payable in semiannual installments, excluding variable interests from 2.7% to 5.6%, through July 1, 2026	\$ 1,130,000
\$940,000, Series 2002, for operational purposes, payable in semiannual installments, excluding variable interests from 1.3% to 7.5%, through July 1, 2026	755,000
\$1,250,000, Series 2007, for construction purposes, payable in semiannual installments, excluding variable interests from 1.5% to 7.0%, through July 1, 2031	1,135,000
\$1,355,000, Series 2009, for construction purposes, payable in semiannual installments, excluding variable interests from 5.0% to 7.0%, through July 1, 2024	1,240,000
\$1,345,000, Series 2011, for operational purposes, payable in semiannual installments, excluding variable interests from 6.0% to 7.5%, through July 1, 2035	1,330,000
\$135,000, Series 2010, for operational purposes, payable in semiannual installments, excluding variable interests from 5.0% to 7.0%, through July 1, 2015	<u>85,000</u>
<b>Total General Obligations – Bonds</b>	<b><u>\$ 5,675,000</u></b>

These bonds (except the Series 2010 amounting \$135,000, that is payable with operational resources, and the Series 2011 amounting \$1,345,000, that is payable with municipal sales and uses taxes resources restricted for debt service), are payable from the special ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

**NOTE 9 – GENERAL LONG-TERM DEBTS (CONTINUED)**

The annual requirements to amortize these bonds obligations, outstanding as of June 30, 2012, are as follows:

Year Ending June 30,	Principal payment	Interest payment	Total
2013	\$ 200,000	\$ 261,218	\$ 461,218
2014	225,000	368,713	593,713
2015	240,000	353,255	593,255
2016	220,000	336,923	556,923
2017	240,000	321,623	561,623
2018-2022	1,495,000	1,332,494	2,827,494
2023-2027	1,840,000	744,078	2,584,078
2028-2032	815,000	305,613	1,120,613
2033-2037	400,000	62,625	462,625
<b>Total</b>	<b><u>\$ 5,675,000</u></b>	<b><u>\$ 4,086,542</u></b>	<b><u>\$ 9,761,542</u></b>

**C. NOTES PAYABLE**

The proceeds of the issuance of notes payables are used principally to pay debt incurred in prior years and to cover the expenditures of a special event. Notes payables as of June 30, 2012, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
\$460,000, Series 2006, for construction purposes, payable in annual installments, excluding interests at 4.50%, through July 1, 2013	\$ 76,000
\$4,640,000, Series 2009, for construction purposes, payable in semiannual installments, excluding variable interests from 1.5% to 7.5%, through July 1, 2033	4,415,000
\$515,000, Series 2010, for operational purposes, payable in semiannual installments, excluding variable interests from 6.0% to 7.5%, through July 1, 2014	<u>330,000</u>
<b>Total Notes Payable</b>	<b><u>\$ 4,821,000</u></b>

The Series 2010 note amounting \$515,000 is payable from the special ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes and the Series 2006 note amounting \$460,000 is payable with operational resources. The Series 2009 amounting \$4,640,000 is payable with municipal sales and uses taxes resources restricted for debt service.

The annual requirements to amortize these bonds obligations, outstanding as of June 30, 2012, are as follows:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 9 – GENERAL LONG-TERM DEBTS (CONTINUED)**

<b>Year Ending June 30,</b>	<b>Principal payment</b>	<b>Interest payment</b>	<b>Total</b>
2013	\$ 266,000	\$ 132,465	\$ 398,465
2014	200,000	334,125	534,125
2015	215,000	318,563	533,563
2016	105,000	306,563	411,563
2017	115,000	298,313	413,313
2018-2022	705,000	1,346,063	2,051,063
2023-2027	1,015,000	1,026,188	2,041,188
2028-2032	1,455,000	567,938	2,022,938
2033-2037	745,000	56,813	801,813
<b>Total</b>	<b><u>\$ 4,821,000</u></b>	<b><u>\$ 4,387,031</u></b>	<b><u>\$ 9,208,031</u></b>

**D. SECTION 515 DIRECT LOAN**

Liabilities of \$1,825,802 reported in the statement of net assets represents the outstanding balance of the Housing Project, Section 515 loan payable. This loan is payable in annual installments, excluding variable interests from 7.0% to 9.0%, through July 1, 2033.

**E. COMPENSATED ABSENCES**

The government-wide statement of net assets includes \$686,549 of accrued sick leave benefits, and \$416,497 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

**F. CLAIMS AND JUDGMENTS**

Liabilities of \$153,422 reported in the statement of net assets represent the balance owed for claims and judgments at June 30, 2012, as described in Note 18.

**G. PROPERTY TAX DEBT – LAW 42**

On January 26, 2000, Act No. 42 was enacted to authorize the CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows for the financing of a debt that the municipalities of Puerto Rico have with the CRIM, arising from the final settlements of property tax advances versus actual collections through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth 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 of August 15, 1999. The outstanding balance of the note payable to the CRIM at June 30, 2012 amounted to \$2,062,329.

**H. PROPERTY TAX DEBT – LAW 146**

On September 24, 2002, the CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Law No. 146 of October 11, 2001. The purpose of this financing agreement was to extinguish in advance certain bonds payable issued by the Public Finance Corporation, a subsidiary of the GDB, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996. The outstanding balance of the note payable to the CRIM at June 30, 2012 amounted to \$487,798.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 9 – GENERAL LONG-TERM DEBTS (CONTINUED)**

**I. LANDFILL OBLIGATION**

The \$1,694,062 reported as landfill obligation at June 30, 2012, represents an estimate related to closure and post closure costs, as described in Note 10.

**NOTE 10 – LANDFILL OBLIGATION**

According to the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991, the Municipality is required to place a final cover on the Municipality's landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with GASB No. 18, the Municipality has to perform a study of the activities that need available space and to comply with applicable state and federal regulations. The Municipality has recorded an estimate liability of \$1,694,062 in the accompanying GWFS, using estimated current costs allocated, based on an estimate of the actual landfill capacity used at June 30, 2012. Actual costs may be different to the recorded estimated liability due to inflation, changes in technology, or changes in Acts and regulations. At June 30, 2012 the Municipality's has not perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities and has not adjusted and estimated liability in accordance with that study.

**NOTE 11 – DEBT RETIREMENT**

Revenues of the debt service fund consist of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality.

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality. Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

**NOTE 12 – PROPERTY TAXES**

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center (CRIM), a governmental entity created by the government of Puerto Rico as part of the Municipal 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. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 12 – PROPERTY TAXES (CONTINUED)**

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.

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 authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money.

Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

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

The annual tax rate is 8.83% for real property and 6.83% 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) 2.00% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 13 – MUNICIPAL LICENSE TAX**

The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2011, the tax rates were as follows:

- ❖ Financial business- 1.50% of gross revenues
- ❖ Other organizations- 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2012 net of allowance for uncollectible.

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

**NOTE 14 – MUNICIPAL SALES AND USE TAXES**

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%.

On September 2, 2008, the Municipal Legislature approved the transfer of 50% from the Municipal Development Fund to the Municipal Redemption Fund, as approved by Law 64 from July 3, 1996, as amended, to increase its debt issuance capacity. Loans issued with those funds can be used for waste management and recycling activities, construction of infrastructure, health and public safety projects and the payroll expenses related to those programs.

**NOTE 15 – INTERGOVERNMENTAL REVENUES**

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the Quasi-public Corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**NOTE 16 – INTERFUND TRANSFERS**

Interfund transfers during the fiscal year ended at June 30, 2012, are summarized as follows:

<b>Transfer Out</b>	<b>Transfer In</b>	<b>Purpose</b>	<b>Amount</b>
General Fund	Debt Service Fund	Debt retirement	\$ 109,765
General Fund	Other Governmental Funds	To reclassify special fund expenditures	14,414
Special Revenue Fund – Federal Grants	General Fund	Reimbursed funds after Governor's Authorized Representative (GAR) audits	496,043
Other Governmental Funds	General Fund	To reclassify operational expenditures	<u>8,600</u>
<b>Total</b>			<b><u>\$ 628,822</u></b>

**NOTE 17 – 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 Commonwealth's legislature. 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 an annual 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 17 – PENSION PLAN (CONTINUED)**

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. 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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

**NOTE 17 – PENSION PLAN (CONTINUED)**

**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	\$ 211,044	\$ 50,066
2011	\$ 188,601	\$ 42,710
2010	\$ 194,768	\$ 40,896

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 provide 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 42004, San Juan, PR 00940.

**NOTE 18 – COMMITMENTS AND CONTINGENCIES**

**A. CLAIMS AND JUDGMENTS**

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 a liability of \$153,422 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

**B. FEDERAL GRANTS**

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. These programs are subject to audit on behalf the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant programs requirements, the Municipality may be required to reimburse these costs, to the grantor agency.

**C. OTHER COMMITMENTS**

At June 30, 2012, the general fund had commitments of approximately \$266,192 for executory purchase orders or contracts that will be honored during the subsequent year.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

**NOTE 19 – ACCOUNTING CHANGES AND RESTATEMENTS**

**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 – Federal Grants	Capital Projects Fund – State & Local Grants	Debt Service Fund	Other Governmental Fund	Total
Fund balance, beginning	\$ 290,770	\$ -	\$ 1,941,369	\$ 2,157,770	\$ 1,491,858	\$ 5,881,767
Cancelled checks	-	-	-	-	12,380	12,380
<b>Fund balance, beginning as restated</b>	<b><u>\$ 290,770</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 1,941,369</u></b>	<b><u>\$ 2,157,770</u></b>	<b><u>\$ 1,504,238</u></b>	<b><u>\$ 5,894,147</u></b>

**B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS**

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

Description	Total
Net assets, beginning	\$ 20,024,475
Cancelled checks	12,380
To correct prior year capital assets accumulated depreciation	(133,616)
<b>Net assets, beginning as restated</b>	<b><u>\$ 19,903,239</u></b>

**NOTE 20 – FUND BALANCE (DEFICIT)**

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

Fund Balance (Deficit)	General Fund	Special Revenue Fund – Federal Grants	Capital Projects Fund – State and Local Grants	Debt Service Fund	Other Governmental Fund	Total
<b>Restricted for:</b>						
General government	\$ 83,051	\$ -	\$ -	\$ -	\$ -	\$ 83,051
Public works					497,741	497,741
Health and welfare					865,954	865,954
Culture and recreation					5,409	5,409
Education					4,000	4,000
Debt service				2,396,525		2,396,525
<b>Unassigned</b>	<b><u>(473,270)</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>(473,270)</u></b>
<b>Total Fund Balance (Deficit)</b>	<b><u>\$ (390,219)</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 2,396,525</u></b>	<b><u>\$ 1,373,104</u></b>	<b><u>\$ 3,379,410</u></b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND  
(SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>(Budgetary Basis)</u> <u>(See Note 1)</u>	<u>Final Budget</u> <u>Positive</u> <u>(Negative)</u>
<b>REVENUES:</b>				
Property taxes	\$ 1,413,916	\$ 1,413,916	\$ 1,413,916	\$ -
Fines and forfeiture	5,000	5,000	1,569	(3,431)
Municipal license tax	1,244,500	1,244,500	1,030,876	(213,624)
Municipal sales and use tax	795,000	795,000	605,698	(189,302)
Licenses, permits and other local taxes	560,000	560,000	177,741	(382,259)
Intergovernmental	5,509,468	5,509,468	5,505,424	(4,044)
Rent of property	135,900	135,900	58,113	(77,787)
Interests	1,500	1,500	53,943	52,443
Miscellaneous	163,200	163,200	465,458	302,258
<b>Total revenues</b>	<u>9,828,484</u>	<u>9,828,484</u>	<u>9,312,738</u>	<u>(515,746)</u>
<b>EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:</b>				
Current:				
General government	5,825,956	5,449,832	6,379,421	(929,589)
Public safety	411,131	465,622	438,577	27,045
Public works	2,233,321	2,430,925	2,268,090	162,835
Health and welfare	681,665	722,264	670,591	51,673
Culture and recreation	566,096	649,526	588,041	61,485
Operating transfer to other funds	110,315	110,315	109,765	550
<b>Total expenditures, encumbrances and other financing uses</b>	<u>9,828,484</u>	<u>9,828,484</u>	<u>10,454,485</u>	<u>(626,001)</u>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)</b>			<u>\$ (1,141,747)</u>	<u>\$ (1,141,747)</u>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of resources:</b>				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 9,312,738
Differences-budget to GAAP:				
GAAP adjustments to revenues				<u>144,471</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 9,457,209</u>
<b>Uses/outflows of resources:</b>				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 10,454,485
Differences-budget to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				357,412
Current year encumbrances recorded as expenditures for budgetary purposes				(183,470)
Operating transfer to other funds				<u>(109,765)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,518,662</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**NOTE 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 GAAP, 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 GAAP 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

<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>
<b>U.S. DEPARTMENT OF AGRICULTURE:</b>			
Pass-through the Commonwealth of Puerto Rico Department of Education: Child and Adult Care Food Program	10.558	Not Available	<u>\$22,433</u>
<b>Total U.S. Department of Agriculture</b>			<u><b>\$22,433</b></u>
<b>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:</b>			
Direct Program: Lower income Housing Assistance Program Section 8 Moderate Rehabilitation	14.856		579,302
Direct Program: Section 8 Housing Choice Voucher Program	14.871		493,814
Pass-through the Commonwealth of Puerto Rico – Office of the Commissioner of Municipal Affairs: Community Development Block Grants – State's Program	14.228	02-AB-FC-RI-07 03-AB-FC-07 04-AB-FC-07 05-AB-FC-07 06-AB-FC-07 07-AB-FC-07 08-AB-FC-07 09-AB-FC-07	653,101
Homeless Prevention and Rapid Re-Housing Program (Recovery Act Funded)	14.262		<u>118,902</u>
<b>Total U.S. Department of Housing and Urban Development</b>			<u><b>1,845,119</b></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

<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>
<b>U.S. DEPARTMENT OF ENERGY</b>			
Energy Efficiency and Conservation Block Grant Program (Recovery Act Funded)	81.128	Not Available	78,464
<b>Total U.S. Department of Energy</b>			<b>78,464</b>
<b>U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:</b>			
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN):			
<b>CCDF Cluster:</b>			
Child Care and Development Block Grant	93.575	Not Available	307,297
ARRA- Child Care and Development Block Grant (Recovery Act funded)	93.713	Not Available	36
<b>Total U.S. Department of Health and Human Services</b>			<b>307,333</b>
<b>U.S. DEPARTMENT OF HOMELAND SECURITY:</b>			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Disaster Grants – Public Assistance	97.036	Not Available	345,536
Homeland Security Grants Program	97.067	Not Available	43,408
<b>Total U.S. Department of Homeland Security</b>			<b>388,944</b>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<b>\$2,642,293</b>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**NOTES OF THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

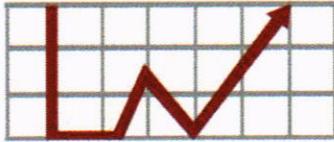
**1. BASIS OF PRESENTATION:**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Arroyo** 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 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:

<b>Description</b>	<b>Special Revenue Fund Federal Grants</b>	<b>Other Governmental Funds</b>	<b>Total</b>
Per Schedule of Expenditures of Federal Awards	\$ 1,780,617	\$ 861,676	\$ 2,642,293
Nonfederal programs expenditures	<u>(96,267)</u>	<u>950,744</u>	<u>854,477</u>
Total Expenditures in the basic financial statements	<u>\$ 1,684,350</u>	<u>\$ 1,812,420</u>	<u>\$ 3,496,770</u>



*López-Vega, CPA, PSC*

Certified Public Accountants / Management Advisors

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- Puerto Rico Society of Certified Public Accountants

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

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

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the **Autonomous Municipality of Ponce, Puerto Rico, (Municipality)** 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 March 5, 2012. The report on the governmental fund financial statements was unqualified but the report on the government wide financial statements has an adverse opinion because we were unable to obtain competent evidential matter related to the solid waste landfill liability. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs, as item **12-03**, to be material weaknesses.

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

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany schedule of finding and questioned costs, as item **12-01**, **12-02**, **12-03** and **12-04**, to be significant deficiencies.

**Compliance and Other Matters**

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

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

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

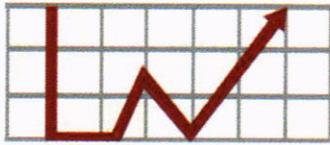


**LOPEZ-VEGA, CPA, PSC**

San Juan, Puerto Rico  
March 5, 2013

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*López-Vega, CPA, PSC*

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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 Arroyo  
Arroyo, Puerto Rico**

**Compliance**

We have audited the **Municipality of Arroyo's** compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the **Municipality of Arroyo's** major federal programs for the year ended June 30, 2012. The **Municipality of Arroyo's** major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Arroyo's** management. Our responsibility is to express an opinion on the **Municipality of Arroyo's** compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable 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 Arroyo's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the **Municipality of Arroyo's** compliance with those requirements.

In our opinion, the **Municipality of Arroyo** complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items **12-05** through **12-10**.

**Internal Control Over Compliance**

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

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items **12-05** thru **12-10**. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention b those charge with governance.

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

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Arroyo** in a separate letter dated March 5, 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  
March 5, 2013

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**Section I – Summary of Auditor’s Results**

**Financial Statements**

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

**Federal awards**

Internal Control over major programs:		
Material weakness identified?	Yes	No X
Significant deficiencies identified not considered to be material weaknesses?	Yes X	None reported

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

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

CFDA Number	Name of Federal Program or Cluster
14.856	Lower Income Housing Assistance Program Section 8 Moderate Rehabilitation
14.871	Section 8 Housing Choice Voucher Program
14.228	Community Development Block Grants – State’s Program
	<b>CCDF - Cluster</b>
93.575	Child Care and Development Block Grant
93.713	ARRA- Child Care and Development Block Grant (Recovery Act funded)

Dollar threshold used to distinguish between Type A and Type B programs	\$300,000
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Auditee qualified as low-risk auditee?	Yes	No X
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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section II – Financial Statements Findings**

**Finding Reference** 12-01

**Requirement** Operating deficit of general fund

**Statement of Condition** As of June 30, 2012, the Municipality closed with an accumulated deficit in its General Fund of \$390,219. The current year operation closed with a net change in fund balances in the General Fund amounting to (\$680,989). The accumulated deficit was caused by the overstatement of estimated revenues and the incurrence of obligations without credits in the budgetary accounts.

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

Article 8.004 (b) establishes no amount shall be expended or obligated in a given fiscal year of if exceeds its budgeted or authorized amounts by the Municipal Legislation.

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

**Cause of Condition** The overstatement of estimated revenues and/ or the incurrence of obligations without credits available of this approved budgetary accounts caused the Municipality to operate with a deficit.

**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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section II – Financial Statements Findings**

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

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

**Questioned Costs**      **None**

**Management Response and Corrective Action**      The Municipality should comply with law and regulation and should prepare a balance budget for the fiscal year 2013-2014 during May 2013. Also, during fiscal year 2013-2014, the Finance Director should monitor the actual revenues and expenditures in order to eliminate the accumulated deficit of \$390,219.

Implementation Date:      June, 2013

Responsible Person:      Ginny Colón  
Finance Department Director

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

Section II – Financial Statements Findings

<b>Finding Reference</b>	12-02
<b>Requirement</b>	<b>Financial Reporting – Accounting Records</b>
<b>Statement of Condition</b>	<p>During our examination of the Municipality's accounting system, we noted that the Municipality's accounting records for Local, State and Federal funds does not provide modified basis financial statements. Also, the accounting system does not offer subsidiaries to produce government wide financial statements. The computerized system provided by the Office of Commissioner of Municipal Affairs (OCAM) and manual system maintained by the finance department personnel do not provide adequate and effective financial information to generate the basic financial statements since the accounts balances were affected by accounting errors in the first years of the system operations.</p> <p>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.</p>
<b>Criteria</b>	Chapter VIII, Article 8.010 of the State Act Number 81 of August 30, 1991, states that the Municipality should maintain an effective and updated accounting system.
<b>Cause of Condition</b>	The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.
<b>Effect of Condition</b>	The Municipality's accounting system did not provide update and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
<b>Recommendation</b>	We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, inter fund transactions, etc.
<b>Questioned Costs</b>	None
<b>Management Response and Corrective Action</b>	The Municipality maintains two sets of accounting records; a manual system and a computerized system provided by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation. In addition, the auditors didn't qualify the government wide financial statements because all necessary information was provided: long-term debts were confirmed by the required Agencies and/or analysis for the

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section II – Financial Statements Findings**

**Finding Reference**      12- 02 (Continued)

**Management Response  
and Corrective Action**    (Continued)

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

Implementation Date:      Already Completed

Responsible Person:      Ginny Colón  
Finance Department Director

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**Section II – Financial Statements Findings**

<b>Finding Reference</b>	12-03
<b>Requirement</b>	<b>Accounting Records- Municipal Solid Waste Landfill Closure and Post-closure Care and Maintenance Costs</b>
<b>Statement of Condition</b>	<p>The Municipality did not adjust in its government wide financial statements, the required liability for closure and post closure costs based on an adequate study of the activities of the solid waste landfill.</p> <p>At June 30, 2012, the Municipality did not realize the required study of the available space and the estimated cost of the closing and post-closing of the Municipality's waste landfill. In addition, the amount of expenses recorded in the financial statements is based on an estimate made by the Municipality's management.</p>
<b>Criteria</b>	<p>Regulations set forth by the U.S. Environmental Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria"; the Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. GASB 18 requires the Municipality to perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality must recognize a liability in its statement of net assets at June 30, 2012.</p>
<b>Cause of Condition</b>	<p>The Municipality did not maintain an adequate control of the accountability of the closure and post closure care costs of Municipal solid waste landfill. In addition, the Municipality did not perform the study required by EPA and GASB 18.</p>
<b>Effect of Condition</b>	<p>The Municipality is not in compliance with GASB 18 and the "Solid Waste Disposal Facility Criteria" issued by the U.S. Environmental Protection Agency.</p>
<b>Recommendation</b>	<p>We recommend management to perform the study of the activities that need to be implement at the Municipality's solid waste landfill facilities and determine the amount of the liability that should be report in the governmental activities.</p>
<b>Questioned Cost</b>	None.
<b>Management Response</b>	<p>During the Transition Process, the Consulting Firm in charge of preparing the financial statements, notes and other supplementary information, informed to the new Administration that they only used the formula to compute the landfill closure and postclosure care costs and the liability recognized in the financial statement provided by auditors of the Municipality in previously audited financial statements. Accordingly, they assumed that this method complied with GAAP.</p>

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section II – Financial Statements Findings**

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

As explained in the condition of the finding, the expense and liability should be based on a study realized by the Municipality. We will further evaluate the calculation of closure and postclosure costs and will proceed with the requirements of the professional standards.

Implementation Date:      June 2013

Responsible Person:      Ginny Colón  
Finance Department Director

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

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**Section II – Financial Statements Findings**

**Finding Reference**        **12-04**

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

**Statement of Condition** We performed a cash disbursements test and examined forty (40) payments which belonged to General Fund, one (1) which belonged to Permanent Improvements account, six (6) which belonged to Joint Resolution, one (1) which belonged to Energy Efficiency and Conservation Block Grant Program, two (2) which belonged to Municipal Improvements and fourteen (14) which belonged to Community Development Block Grants – State's Program (CDBG). The following will summarize the internal control exceptions noted:

- a. In six (6) payments which belonged to General Fund and one (1) which belonged to Permanent Improvements, the disbursement vouchers did not include the purchase order.
- b. Three (3) payments which belonged to Joint Resolutions one (1) which belonged to Permanent Improvements and four (4) payment voucher from the General Fund did not include the certification that the Municipality or any Municipality's employee will not benefit from the goods or services received under contract.
- c. Five (5) payments which belonged to General Fund and one (1) payment which belonged to Permanent Improvements did not include the requisitions in the disbursement vouchers.
- d. In one (1) payment which belonged to Community Development Block Grants – State's Program (CDBG), the Purchase Order was not issued before the receiving of good or services.
- e. In three (3) payments which belonged to General Fund, the disbursement vouchers did not include the invoice.
- f. In four (4) payments which belonged to General Fund, the disbursement vouchers did not include at least three quotations for the purchase.
- g. In three (3) payments which belonged to General Fund, the disbursement vouchers did not include all required signatures.
- h. In four (4) payments which belonged to General Fund and one (1) which belonged to Joint Resolution, the disbursement vouchers weren't available for our examination.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section II – Financial Statements Findings**

<b>Finding Reference</b>	<b>12-04 (Continued)</b>
<b>Criteria</b>	"Reglamento para la Administración Municipal" establish in the Chapter Four (4) that the Finance Director will be responsible to account and prepare disbursements through documents duly prepared and certified, including sufficient evidential matter to support the transactions.
<b>Cause of Condition</b>	The Municipality internal control procedures failed to assure that all transactions include all the required documentation and approvals.
<b>Effect of Condition</b>	The Municipality is not in compliance with Chapter Four (4) of the "Reglamento para la Administración Municipal".
<b>Recommendation</b>	We recommend that the Municipality should improve its internal control and procedures in order to assure that the disbursement vouchers contain all the necessary supporting documents before making the payments and are available for examination.
<b>Questioned Costs</b>	None
<b>Management Response and Corrective Action</b>	We are improving our internal controls in order to assure that all required information is obtained before making a disbursement.  Implementation Date: June 2013  Responsible Person: Ginny Colón Finance Department Director

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	12-05
<b>Programs</b>	Section 8 Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (CFDA 14.856) U.S. Department of Housing and Urban Development
<b>Requirement</b>	Special Test – Establishment and Maintenance of a Replacement Reserve
<b>Statement of Condition</b>	In our audit process, we could not identify that a replacement reserve was properly established, required monthly deposits were made, or that disbursements were only for approved purposes.
<b>Criteria</b>	Code of Federal Regulations 24, Section 880.602 (a) states that a replacement reserve must be established and maintained in an interest-bearing account to aid in funding extraordinary maintenance and repair and replacement of capital items.
<b>Cause of Condition</b>	The Municipality controls and procedures failed to assure that a replacement reserve was establish in an interest-bearing account as required by Federal Regulation for the purpose of extraordinary maintenance and repairs and replacement of capital items.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, section 880.602 (a).
<b>Recommendation</b>	We recommend management to improve monitoring procedures to assure that the owner of the project establish and maintain a replacement reserve, make the required deposits to the reserve and perform all repair and maintenance functions (including ordinary and extraordinary maintenance), and replacement of capital items, as stated in the federal regulation.
<b>Questioned Costs</b>	None
<b>Management Response and Correction Action</b>	We are improving our internal controls in order to adequately monitor that the replacement reserve transfers are made when due.  Implementation Date: June 2013  Responsible Person: Juan Devarie Section 8 Program Coordinator

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	12-06
<b>Programs</b>	<b>Section 8 Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (CFDA 14.856) U.S. Department of Housing and Urban Development</b>  <b>Section 8 Housing Choice Vouchers Program (CFDA 14.871); U.S. Department of Housing and Urban Development</b>
<b>Requirement</b>	<b>Special Test – Selection from the Section 8 Waiting List</b>
<b>Statement of Condition</b>	In our Waiting List test, we noted the following situations: <ul style="list-style-type: none"><li>a. The PHA did not have written policies in its HCVP administrative plan for selecting applicants from the waiting list.</li><li>b. The PHA has no evidence of the public notice to the families when it opened and closed the waiting list.</li></ul>
<b>Criteria</b>	Code of Federal Regulations 24, Sections 982.54 (d) and 982.201 through 982.207 states the waiting list procedures and that the selection from the waiting list generally occurs when the PHA notifies a family, whose names reaches the top of the waiting list, to come in to verify eligibility for admission.
<b>Cause of Condition</b>	The Municipality internal control procedures failed to assure that the waiting list include all information required by Federal Regulation and that the participants were selected from the top of the waiting list.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, sections 982.54 (d) and 982.201 through 982.207.
<b>Recommendation</b>	We recommend management to improve monitoring procedures to assure that the participants are admitted to the program or are provided the opportunity to be admitted to the program according with the federal regulation.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**      12-06 (Continued)

**Questioned Costs**      None

**Management Response  
and Correction Action**

We will revise the HCVP administrative plan in order to assure that the selection of participants are made according to federal regulations.

Implementation Date:      June 2013

Responsible Person:      Juan Devarie  
Federal Programs Department Director

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section III – Major Federal Award Program Findings and Questioned Costs**

<b>Finding Reference</b>	12-07
<b>Program</b>	Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development
<b>Requirement</b>	Special Test – Depository Agreements
<b>Statement of Condition</b>	During our audit, we noted that the Municipality did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999)
<b>Criteria</b>	Code of Federal Regulations 24, Subpart D, 982.156 states. (c) The PHA must enter into an agreement with the depository in the form required by HUD. (d) If required under a written freeze notice from HUD to the depository: (i) The depository may not permit any withdrawal by the PHA of funds held under the depository agreement unless expressly authorized by written notice from HUD to the depository; and (ii) The depository must permit withdrawals of such funds by HUD. (2) HUD must send the PHA a copy of the freeze notice from HUD to the depository.
<b>Cause of Condition</b>	The program is not performing an effective review of compliance requirement that are required by HUD.
<b>Effect of Condition</b>	The PHA is not in compliance with laws and established regulation as prescribed by HUD.
<b>Recommendation</b>	Procedures should be implemented to ascertain that the PHA complies with the established Federal Regulation, as prescribed by HUD.
<b>Questioned Costs</b>	None
<b>Management Response and Corrective Action</b>	Depository agreements will be obtained to comply with federal regulations.  Implementation Date: June 2013  Responsible Person: Ginny Colón Finance Department Director

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	12-08
<b>Program</b>	Community Development Block Grants – State’s Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
<b>Requirement</b>	Davis-Bacon Act
<b>Statement of Condition</b>	<p>During our Davis-Bacon Act test, we verified one (1) construction project. The following will summarize the exceptions noted:</p> <ul style="list-style-type: none"><li>a) We noted that during the fiscal year 2011-2012, the Municipality did not apply adequate monitoring procedure to required on-site visits to monitor the classifications of workers and wage rates paid.</li><li>b) We did not obtain evidence that the Municipality’s monitors certified the weekly payroll supplied by the contractors.</li><li>c) The contractor did not submit the certifications and copies of payroll. (Weekly payroll)</li></ul>
<b>Criteria</b>	Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
<b>Cause of Condition</b>	The Municipality’s controls and procedures failed to apply all monitoring system procedures developed to test applicable contractors with respect to payment of prevailing wages.
<b>Effect of Condition</b>	The Municipality is not in compliance with Davis-Bacon Act, as amended DOL (40 USC 276a to 276a-7).
<b>Recommendation</b>	<p>We recommend that the Municipality should establish defined procedure to monitor the enforcement of the Act’s regulation. Those procedures should including the following:</p> <ul style="list-style-type: none"><li>a) On site visits;</li><li>b) Obtain contractor’s and subcontractor’s weekly payrolls to be reviewed on a weekly basis to establish the degree of compliance and the nature and extend of violations, if any, and then, communicate contractors promptly about any failure in the payroll process.</li></ul>

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**      12-08 (Continued)

**Questioned Costs**      None

**Management Response  
and Corrective Action**

The Davis-Bacon Act requires us to verify that the contractor or subcontractor submitted weekly the required certified payrolls. According to the condition, we are not required to perform on-site visits of the projects. In addition, in section (b) of the finding, the auditors established that we didn't certify the weekly payroll submitted by the contractor; and in section (c) established that the contractor did not submit the certifications. We understand that the payrolls were submitted to the auditors for their evaluation based on the condition. No further action is required.

Implementation Date:      June 2013

Responsible Person:      Ginny Colón  
Finance Department Director

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	12-09
<b>Program</b>	Community Development Block Grant – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through State – Office of Commissioner of Municipal Affairs
<b>Requirement</b>	Program Income
<b>Statement of Condition</b>	<p>During our audit of the program income requirements we noted that the Municipality did not maintain internal controls to assure the proper determination, accounting and use of program income, as discuss below:</p> <ul style="list-style-type: none"><li>a. Program income records were not available for our examination.</li><li>b. Program income was not reported in accordance with the program requirements and other regulations applicable.</li></ul>
<b>Criteria</b>	<p>Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. And Code of Federal Regulations 24, Part 570.489 (b) (2)</p> <p>Code of Federal Regulations 24, Part 570.489 (e) (3) HUD requires vigorous state oversight of recovered funds retained at the local level. Community Development has the ultimate responsibility for the proper use of these funds and must ensure that Program Income is used in a manner consistent with requirements. For this reason, annual Program Income/Miscellaneous Revenue Reports are required (see Attachment 4-1). A grantee with the potential of generating recapture funds must submit a report for the fiscal year ending June 30.</p>
<b>Cause of Condition</b>	The Municipality did not maintain adequate internal controls in order to assure the proper determination, accounting and use of program income.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Part 85.20 (b) (2), and Code of Federal Regulations 24, Part 570.489 (e) (3).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**Section III – Major Federal Award Program Findings and Questioned Costs**

**Finding Reference**      **12-09 (Continued)**

**Recommendation**      We recommend management to develop internal controls and procedures in order to assure that the handling of Program Income complies with federal and state requirements

**Questioned Costs**      None

**Management Response  
and Corrective Action**      Procedures will be verified in order to assure compliance with federal awards.

Implementation Date:      June 2013

Responsible Person:      Ginny Colón  
Finance Department Director

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	12-10
<b>Program</b>	Child Care and Development Block Grant (CFDA No. 93.575); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico - Administration for Children and Families  ARRA- Child Care and Development Block Grant (Recovery Act funded); (CFDA No. 93.713); U.S. Department of Health and Human Services; Pass through the Commonwealth of Puerto Rico - Administration for Children and Families
<b>Requirement</b>	Reporting Financial – Administration
<b>Statement of Condition</b>	During our audit, we noted that the Municipality did not maintain adequate accounting records for the Child Care and Development Block Grant Program. However, the Municipality hires the professional services of external accountants to perform the trial balance of the program. These accountants obtain the information from various sources, departments and persons within the Municipality.  Also the Municipality did not have evidence that the annual closing report was submitted timely.
<b>Criteria</b>	Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income.
<b>Cause of Condition</b>	The Municipality did not maintain adequate controls and accounting records to assure the accountability of all Federal transactions in accordance with Federal regulations.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (2).
<b>Recommendation</b>	We recommend that the Municipality should implement controls and procedures in order to assure that an accurate set of accounting records will be maintained and all report submitted.
<b>Questioned Cost</b>	None.



**COMMONWEALTH OF PUERTO RICO  
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**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
11-03	14.856	<p><u>In our audit process, we could not identify that a replacement reserve was properly, required monthly deposits were made, and disbursements were only for approved purposes.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-03</p>
11-04	14.856	<p><u>In our Waiting List test, we noted the following situation: We could not identify the process of the opening of a new Waiting List and could not verify the process of admission of new participants to the programs. The Waiting List did not include the racial or ethnic designation of the head of household.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-04</p>
11-05	14.871	<p><u>During our audit, we noted that the Municipality did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999)</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-05</p>
11-06	14.228	<p><u>During our Davis-Bacon Act test, we verified one (1) construction project. The following will summarize the exceptions noted: We noted that during the fiscal year 2010-2011, the Municipality did not perform the required on-site visits to monitor the classifications of workers and wage rates paid; The contractor did not submit all the weekly certified payrolls during the contracts period; We did not obtain evidence demonstrating that the Municipality's monitors certified the weekly payroll supplied by the contractors.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-06</p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
10-07	93.575	<p><u>During our audit we noted that the Municipality did not maintain, for the Child Care and Development Block Grant Program, a reliable set of accounting records that present the financial position of the program, the results of operations and changes in fund balance.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-10</p>
10-03	14.856	<p><u>In our audit process, we noted the following situation: we could not identify that a replacement reserve was properly established, required monthly deposits were made, and disbursements were only for approved purposes.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 11-03</p>
10-04	14.856 & 14.871	<p><u>In our Waiting List test, we noted the following situation: we could not identify the process of the opening of a new Waiting List and could not verify the process of admission of new participants admitted in the programs: the Waiting List did not include the racial or ethnic designation of the head of household.</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-04</p>
10-05	14.871	<p><u>During our verification, we noted that the Municipality did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999)</u></p> <p>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 12-05</p>
09-03	14.856 & 14.871	<p><u>In our Waiting List test, we noted the following situation: During the year, the Municipal Housing Office was robbed. Several documents and programs' equipment were taken from the premises, including computers where the program kept the waiting list. We could not verify the process of admission of new participants in the programs due to this situation.</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 clearinghouse</p>
09-04	14.871	<p><u>During our verification, the Municipality did not perform the required Housing Quality Control re-inspections during the fiscal year 2008-2009.</u></p>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**SCHEDULE OF PRIOR YEARS AUDIT FINDINGS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Original Finding Number	CFDA No.	Current Status of Prior Audit Findings
		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 clearinghouse
09-05	14.228	<p><u>During our audit, the Municipality did not maintain Housing Rehabilitation records for the fiscal year ended June 30, 2009, to present the position and the results of operations of the Program.</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 clearinghouse</p>
09-06	14.228	<p><u>We performed a housekeeper activities test of ten (10) participant's files and found the following exception: In one (1) participant's files, we did not find evidence that demonstrate if the program staff visited at least two (2) times per month the participant housing unit to ensure the quality of services. In ten (10) participant's file, we noted that the Service Coordinator did not performed visit to the applicant housing unit to verify location of it. In two (2) participant's files, we noted that, as part of the visits procedures, the Service Coordinator did not document in the Form OCAM-AH-006, the housekeeper performance.</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 clearinghouse</p>
09-07	14.228	<p><u>During our Cash Management test, we noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. We selected a sample of six (6) fund requisitions (a total of \$529,719) and found the following exception: In three (3) fund requisitions (a total of \$175,127), we observed that the Municipality made the disbursements between six (6) and thirty six (36) days after the deposits.</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 clearinghouse</p>