



*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

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Arroyo, Puerto Rico (Municipality), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluation the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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## INDEPENDENT AUDITORS' REPORT (CONTINUED)

### **Basis for Adverse of Opinion on the Government – Wide Financial Statements**

Due to the inappropriateness of the Municipality's accounting records over fixed assets, we were unable to obtain adequate audit evidence regarding the amounts at which capital assets, accumulated depreciation and net investment in capital assets, are recorded in the accompanying statement of net position at June 30, 2014, stated at \$12,011,423, \$22,691,270 and \$25,753,653. Depreciation expense has been recorded for those assets in the fiscal year 2014. Accounting principles generally accepted in the United States of America require that those assets be capitalized and depreciated, which would increase the assets, net position and expenses of the governmental activities.

Besides, the Municipality did not comply with 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 (EPA). At June 30, 2014, the accompanying statement of net position presents a liability for post-closure care costs of the Municipality's solid waste landfill of \$1,694,062. However, this estimate has not been made based a study in conformity with the regulatory requirements established by the EPA "*Solid Waste Disposal Facility Criteria*". The amount by which departure would affect the liabilities, net position and expenses of the governmental activities is not reasonably determinable.

As a result of these matters, we were unable to determine whether any audit adjustments might have been found necessary in respect of recorded or unrecorded capital assets and liability for post-closure care costs and the elements making up the Statement of Net Position and Statement of Activities.

### **Adverse of Opinion – Government – Wide Financial Statements**

Because of the significance of the matters described in the *Basis for Adverse Opinion* paragraphs, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for our audit opinion and accordingly, we do not express an opinion on the government wide financial statements of the **Municipality of Arroyo, Puerto Rico**, as of June 30, 2014, as to whether they have been properly prepared, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

### **Other Matters**

#### Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages **4** through **10** and **50** 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.



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## INDEPENDENT AUDITORS' REPORT (CONTINUED)

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2015, on our consideration of the Municipality of Arroyo' 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* in considering the Municipality of Arroyo' internal control over financial reporting and compliance.



**LOPEZ-VEGA, CPA, PSC**

San Juan, Puerto Rico  
March 10, 2015

Stamp No. 2705432 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.



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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, 2014. 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.

The new reporting model required by Governmental Accounting Standards Board Statement No. 34 was implemented during fiscal 2003-2004. 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 assets of the Municipality exceeded its liabilities at June 30, 2014 by \$20,906,303, and at June 30, 2013 by \$19,468,963;
- ❖ The Municipality's total net position increase by \$1,437,340 during fiscal year 2013-2014;
- ❖ As of June 30, 2014, the Municipality's governmental funds reported combined ending fund balances of \$3,383,234, an increase of \$653,488 from the prior year;
- ❖ At June 30, 2014, the unrestricted deficit was \$9,600,042;
- ❖ The Municipality's capital assets inventory increase as a result of this year's operations. Capital assets net of depreciation as of June 30, 2014 was \$34,702,693;
- ❖ The investment in capital assets for this year was \$741,928;
- ❖ Loans principal payments were \$507,958 and \$668,563 in 2014 and 2013, 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.

## GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide 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.

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

The Statement of Net Position presents information on all of the Municipality's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

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 general government, public safety, public works, culture and recreation, health and sanitation, solid waste disposal, human services and welfare, urban development and education. Property taxes, municipal license tax, state and federal grants finance most of these activities.

## **FUND FINANCIAL STATEMENTS**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

## **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.

**GOVERNMENT-WIDE FINANCIAL ANALYSIS**

**GOVERNMENTAL NET POSITION**

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the Municipality, net position exceeded liabilities by \$20,906,303 as of June 30, 2014 versus \$19,468,963 as of June 30, 2013. Our analysis below focuses on the net position (**Table 1**) and changes in net position of the Municipality's governmental activities.

<b>Table 1</b> <b>Statement of Net Position</b>	<b>2014</b>	<b>2013</b>
Current and non-current assets	\$ 7,529,092	\$ 4,762,143
Capital assets	34,702,693	34,141,412
<b>Total Assets</b>	<b>42,231,785</b>	<b>38,903,555</b>
Current liabilities	3,236,852	1,589,092
Long-term liabilities	18,088,630	17,845,500
<b>Total Liabilities</b>	<b>21,325,482</b>	<b>19,434,592</b>
<b>Deferred Inflows of Resources</b>	<b>-</b>	<b>-</b>
Net position:		
Investment in capital assets, net of related debt	25,753,653	28,694,022
Restricted	4,752,692	3,250,257
Deficit	(9,600,042)	(12,475,316)
<b>Total Net Position</b>	<b>\$ 20,906,303</b>	<b>\$ 19,468,963</b>

The largest portion of the Municipality's net position reflects its investment in capital assets (e.g. land, buildings, infrastructure, 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 position represents resources that are subject to external restrictions on how they may be used.

Total net position of the Municipality's governmental activities were \$20,906,303. The unrestricted deficit was \$9,600,042 at June 30, 2014, an increase of \$1,437,340 from prior year.

**GOVERNMENTAL ACTIVITIES**

Governmental activities increased the Municipality's net position. Key elements of this increase are as follows: the Municipality's governmental activities had net expenses of \$10,642,445. 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 covered net expenses and there was a net change of \$1,437,340. In addition, 2014 revenues increased \$2,687,257 in comparison with 2013 revenues. In the other hand expenses were \$166,996 less compare to 2013 expenses.

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

GOVERNMENTAL ACTIVITIES (CONTINUED)

Table 2 presents the cost of each of the Municipality's largest programs.

<u>Table 2</u> <u>Statement of Activities</u>	<u>2014</u>	<u>2013</u>
Revenues		
Grants and contributions	\$ 4,337,208	\$ 2,960,063
General revenues:		
Property taxes	1,927,170	1,850,759
Municipal license taxes	1,071,583	1,014,443
Sales tax	1,103,892	1,163,561
Construction excise tax	112,601	244,753
Intergovernmental	7,267,935	6,457,992
Rent	63,209	64,067
Miscellaneous	533,395	137,365
Charges for services	163,267	-
Total revenues	<u>16,580,260</u>	<u>13,893,003</u>
Expenses		
Mayor and Municipal Legislature	1,489,634	2,353,459
General government	5,898,380	4,869,985
Public safety	441,958	557,684
Public works	1,982,262	1,806,792
Culture and recreation	825,032	993,294
Sanitation	538,213	258,169
Human services and welfare	2,900,527	2,876,493
Urban development	652,146	1,137,394
Interest on long-term debts	414,768	456,646
Total expenses	<u>15,142,920</u>	<u>15,309,916</u>
Changes in net position	1,437,340	(1,416,913)
Net position – beginning	<u>19,468,963</u>	<u>20,885,876</u>
Net position – ending	<u>\$ 20,906,303</u>	<u>\$ 19,468,963</u>

GOVERNMENT FUND FINANCIAL ANALYSIS

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

GOVERNMENT FUND FINANCIAL ANALYSIS (CONTINUED)

<b>Table 3</b>		
<b>Balance Sheet</b>	<b>2014</b>	<b>2013</b>
Assets:		
Total assets – Major Funds	\$ 4,495,180	\$ 4,081,537
Total assets – Other Funds	4,443,556	1,542,900
Combined total assets	<u>8,938,736</u>	<u>5,624,437</u>
Liabilities:		
Total liabilities – Major Funds	3,213,311	2,287,802
Total liabilities – Other Funds	1,433,185	489,095
Combined total liabilities	<u>4,646,496</u>	<u>2,776,897</u>
Deferred Inflows of Resources:		
Total Deferred Inflows – Major Funds	909,006	105,041
Total Deferred Inflows – Other Funds	-	12,753
Combined total deferred inflows of resources	<u>909,006</u>	<u>117,794</u>
Fund Balances:		
Restricted	4,752,692	5,425,033
Unassigned	(1,369,458)	(2,695,287)
Combined total fund balances	<u>3,383,234</u>	<u>2,729,746</u>
<b>Total liabilities and fund balances</b>	<b>\$ 8,938,736</b>	<b>\$ 5,624,437</b>

<b>Table 4</b>		
<b>Changes in Fund Balances</b>	<b>2014</b>	<b>2013</b>
Revenues:		
Total revenues – Major Funds	\$ 12,340,740	\$ 10,783,770
Total revenues – Other Funds	3,871,865	3,252,050
Combined total revenues	<u>16,212,605</u>	<u>14,035,820</u>
Expenditures:		
Total expenditures – Major Funds	12,380,340	11,712,060
Total expenditures – Other Funds	3,178,777	3,149,310
Combined total expenditures	<u>15,559,117</u>	<u>14,861,370</u>
Excess of revenues over (expenditures)	<u>653,488</u>	<u>(825,550)</u>
Other financing sources (uses):		
Transfer – In	1,310,131	658,686
Transfer – Out	(1,310,131)	(658,686)
Combined other financing sources (uses), net	<u>-</u>	<u>-</u>
Net changes in fund balance	653,488	(825,550)
Fund Balance – beginning	2,729,746	3,555,296
<b>Fund Balance – ending</b>	<b>\$ 3,383,234</b>	<b>\$ 2,729,746</b>

## 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, 2014, the Municipality's governmental funds reported combined ending fund balances of \$3,383,234, an increase of \$653,488 from the prior year.

The Municipality has an unassigned fund deficit of (\$1,369,458) in its General Fund. The remainder of the balance is restricted to indicate that it is not available for new spending because it has already been segregated; (a) to pay debt service (\$1,068,230), (b) for housing project (\$634,770) and (c) for other restricted purposes (\$3,010,371).

## 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.

After the original budget is approved, it may be revised for a variety of reasons such as unforeseen circumstances and other unanticipated revenues. Differences between the original 2014 budget and the final amended budget for the General Fund were relatively minor and can be summarized as follows:

- ❖ The original budget was amended to increase expenditures between expenditures accounts.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

The Municipality's investment in capital assets for its governmental type activities as of June 30, 2014 amounted to \$34,702,693 (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, parks, roads, highways, and bridges. The total increase in the Municipality's investment in capital assets for the current fiscal year was \$741,928. Additions during the fiscal year was principally for building construction, purchase of new vehicles and machinery and equipment, necessary to provides services to our citizens. **Table 5** present the major classes of capital assets.

<b>Table 5</b>	
<b>Capital Assets</b>	<b>Amount</b>
Construction in progress	\$ 1,707,339
Land	9,705,674
Land- Housing Project	595,000
Work of art	3,410
Depreciable capital assets	22,149,518
Depreciable capital assets- Housing Project	541,752
<b>Total Assets</b>	<b>\$ 34,702,693</b>

## LONG-TERM DEBT

At June 30, 2014, the Municipality had a total of \$18,513,630 in general obligations and others outstanding debts, as shown in **Table 6**. Of this amount, \$9,605,000 comprises debt backed by the full faith and credit of the government and \$8,908,630 is other obligations.

<b>Table 6</b>	
<b>Long Term Debts</b>	<b>Amount</b>
General obligations	\$ 9,605,000
Others	<u>8,908,630</u>
<b>Total Long Term Debts</b>	<b><u>\$ 18,513,630</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, volume of business 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 2015 fiscal year. Some cost reductions helped fund improvements of existing facilities, public safety and works, economic development initiatives and human service improvements.

## 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 or P.O. Box 477, Arroyo, P.R. 00714.

	Governmental Activities
<b>Assets</b>	
Cash and cash equivalents	\$ 2,215,680
Cash with fiscal agents	3,040,870
Restricted cash and funded reserves	646,706
Accounts receivable:	
Property tax	5,442
Municipal sales and use tax	88,085
Construction excise tax	38,400
Federal grants	150,865
Intergovernmental	1,226,175
Miscellaneous	111,384
Other assets	5,485
Capital assets	
Land, improvements, and construction in progress	12,011,423
Other capital assets, net of depreciation	22,691,270
Total capital assets	<u>34,702,693</u>
<b>Total assets</b>	<u><u>42,231,785</u></u>
<b>Liabilities</b>	
Bank overdraft	
Accounts payable and accrued liabilities	5,874,336
Bonds and Notes Payable	52,587
Interest payable	297,015
Noncurrent liabilities:	
Due within one year	1,496,376
Due in more than one year	16,592,254
<b>Total liabilities</b>	<u><u>24,312,568</u></u>
<b>Net Position</b>	
Net investment in capital assets	25,753,653
Restricted for:	
Housing Project	634,770
Debt service	1,068,230
Other purposes	3,049,692
Unrestricted (deficit)	<u>(9,600,042)</u>
<b>Total net position</b>	<u><u>\$ 20,906,303</u></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**Statement of Activities  
For the Year Ended June 30, 2014**

Functions/Programs	Expenses	Program Revenues		Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Position
		Charges for Services	Operating Grants and Contributions		Governmental Activities
Mayor and Municipal Legislature	\$ (1,489,634)	\$ -	\$ -	\$ -	\$ (1,489,634)
General government	(5,898,380)				(5,898,380)
Public safety	(441,958)		54,882		(387,076)
Public works	(1,982,262)		198,561		(1,783,701)
Culture and recreation	(825,032)		12,000		(813,032)
sanation	(538,213)	119,582			(418,631)
Health and welfare	(2,900,527)	43,685	2,179,359		(677,483)
Urban development	(652,146)			1,892,406	1,240,260
Interest on long-term debt	(414,768)	-	-	-	(414,768)
<b>Total governmental activities</b>	<b>\$ (15,142,920)</b>	<b>\$ 163,267</b>	<b>\$ 2,444,802</b>	<b>\$ 1,892,406</b>	<b>(10,642,445)</b>

General revenues:

Taxes:

Property tax, levied for general purposes	1,335,734
Property tax, levied for debt services	591,436
Municipal license tax	1,071,583
Municipal sales and use tax	1,103,892
Construction excise tax	112,601
Intergovernmental	7,267,935
Rent	63,209
Miscellaneous	533,395

Total general revenues	12,079,785
Change in net position	1,437,340
Net position - beginning, as restated	19,468,963
Net position - ending	<u>\$ 20,906,303</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**Balance Sheet-Governmental Funds  
For the Year Ended June 30, 2014**

	General Fund	Housing Project Brisas de Arroyo Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
<b>Assets</b>					
Cash and cash equivalents	\$ -	\$ 39,709	\$ -	\$ 2,175,971	\$ 2,215,680
Cash with fiscal agents	39,321		1,595,559	1,405,990	3,040,870
Restricted cash and funded reserves		646,706			646,706
Accounts receivable:					-
Property taxes			5,442		5,442
Municipal sales and use tax	54,105		33,980		88,085
Construction excise tax	38,400				38,400
Federal grants	4,502			146,363	150,865
Intergovernmental	909,006			317,169	1,226,175
Miscellaneous	111,384				111,384
Due from other funds	1,011,581			398,063	1,409,644
Other assets	-	5,485	-	-	5,485
<b>Total assets</b>	<b>\$ 2,168,299</b>	<b>\$ 691,900</b>	<b>\$ 1,634,981</b>	<b>\$ 4,443,556</b>	<b>\$ 8,938,736</b>
<b>Liabilities, Deferred Inflows of Resources and Fund balances (deficit)</b>					
Bank overdraft	\$ 181,993	\$ -	\$ -	\$ -	\$ 181,993
Accounts payable and accrued liabilities	591,605	41,312		105,623	738,540
Bonds and notes payable			425,000		425,000
Accrued interest			141,751		141,751
Due to:					
Commonwealth government	453,587			76,287	529,874
Other funds	398,063			1,011,581	1,409,644
Deposits and prepayment liabilities		15,818			15,818
Unearned revenues:					
Municipal license tax	964,182				964,182
Federal grants	-	-	-	239,694	239,694
<b>Total liabilities</b>	<b>2,589,430</b>	<b>57,130</b>	<b>566,751</b>	<b>1,433,185</b>	<b>4,646,496</b>
<b>Deferred Inflows of Resources</b>					
Unavailable revenues:					
Intergovernmental	909,006	-	-	-	909,006
<b>Total Deferred Inflows of Resources</b>	<b>909,006</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>909,006</b>
<b>Fund balances (deficit):</b>					
Restricted	39,321	634,770	1,068,230	3,010,371	4,752,692
Unassigned	(1,369,458)	-	-	-	(1,369,458)
<b>Total fund balances (deficit)</b>	<b>(1,330,137)</b>	<b>634,770</b>	<b>1,068,230</b>	<b>3,010,371</b>	<b>3,383,234</b>
<b>Total liabilities, deferred inflows of resources and fund balances (deficit)</b>	<b>\$ 2,168,299</b>	<b>\$ 691,900</b>	<b>\$ 1,634,981</b>	<b>\$ 4,443,556</b>	<b>\$ 8,938,736</b>

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO

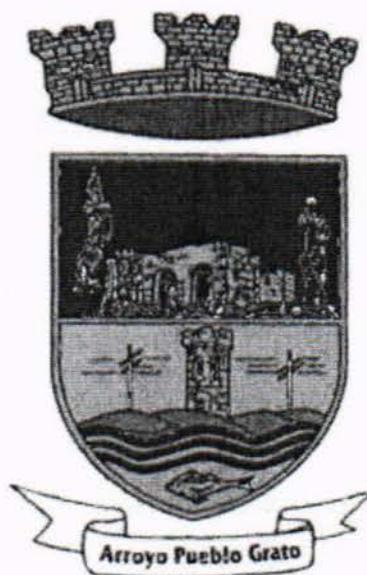
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BASIC FINANCIAL STATEMENTS  
WITH ADDITIONAL REPORTS AND INFORMATION  
REQUIRED BY THE SINGLE AUDIT ACT

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Year Ended June 30, 2014

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

Hon. Eric Bachier Román

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**Statement of Revenues, Expenditures and Changes  
in Fund Balance (Deficit)-Governmental Funds  
For the Year Ended June 30, 2014**

	General Fund	Housing Project Brisas de Arroyo Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
<b>Revenues</b>					
Property taxes	\$ 1,335,734	\$ -	\$ 591,436	\$ -	\$ 1,927,170
Municipal license taxes	1,071,583				1,071,583
Municipal sales and use tax	643,512		460,380		1,103,892
Intergovernmental	6,900,280			1,999,404	8,899,684
Construction excise tax	112,601				112,601
Rent of property	63,209				63,209
Federal grants		509,028		1,833,587	2,342,615
Charges of services	119,582			4,898	124,480
Miscellaneous	533,395			33,976	567,371
<b>Total revenues</b>	<b>10,779,896</b>	<b>509,028</b>	<b>1,051,816</b>	<b>3,871,865</b>	<b>16,212,605</b>
<b>Expenditures</b>					
Current:					
Mayor and Municipal Legislature	\$ 1,489,634.00	\$ -	\$ -	\$ -	\$ 1,489,634.00
General government	5,244,466			80	5,244,546
Public safety	388,520			48,858	437,378
Public works	1,881,785			100,477	1,982,262
Culture and recreation	788,944			31,985	820,929
Sanitation	513,405			24,808	538,213
Health and welfare	823,772	297,560		1,668,398	2,789,730
Urban development	29,528			1,304,171	1,333,699
Debt service:					
Principal		52,958	455,000		507,958
Interest		126,645	288,123		414,768
<b>Total expenditures</b>	<b>11,160,054</b>	<b>477,163</b>	<b>743,123</b>	<b>3,178,777</b>	<b>15,559,117</b>
Excess (deficiency) of revenues over (under) expenditures	(380,158)	31,865	308,693	693,088	653,488
Other financing sources (uses)					
Transfers in			33,900	1,276,231	1,310,131
Transfers out	(167,383)		(1,142,748)		(1,310,131)
<b>Total other financing sources (uses)</b>	<b>(167,383)</b>	<b>-</b>	<b>(1,108,848)</b>	<b>1,276,231</b>	<b>-</b>
Net change in fund balances (deficit)	(547,541)	31,865	(800,155)	1,969,319	653,488
Fund balance (deficit), beginning as restated	(782,596)	602,905	1,868,385	1,041,052	2,729,746
Fund balance (deficit), ending	<u>\$ (1,330,137)</u>	<u>\$ 634,770</u>	<u>\$ 1,068,230</u>	<u>\$ 3,010,371</u>	<u>\$ 3,383,234</u>

*Handwritten signature and date:*  
06/03/2015

Total Fund Balances - Governmental Funds \$ 3,383,234

Amounts reported for Governmental Activities in the Statement of Net Position 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:

Capital Assets	54,967,679	
Accumulated depreciation	(20,264,986)	
Total Capital Assets		34,702,693

Other assets are not available to pay current-period expenditures and, therefore, are reported as deferred inflows of resources in the funds:

Due from Commonwealth Government:		
P.R. Electric Power Authority (PREPA)	850,349	
Christmas bonus reimbursement	58,657	
Total Deferred Inflows of Resources		909,006

Long-term liabilities, including bonds and notes payable, are not due and payable in the current period and, therefore, are not reported in the funds:

General obligation bonds and notes	(9,180,000)	
Public Act No. 42 January 20, 2001	(1,979,494)	
Public Act No. 146 of October 11, 2001	(438,968)	
Section 515 loan program	(1,724,040)	
Compensated absences	(1,486,612)	
Post-closure care costs	(1,694,062)	
Christmas bonus	(126,288)	
P.R. Department of Labor	(448,069)	
Claims and judgments	(15,139)	
Crim final settlement	(96,006)	
Retirement System Administration	(49,603)	
Payable to PREPA	(850,349)	
Total Long-Term Liabilities		(18,088,630)

Total Net Position of Governmental Activities \$ 20,906,303

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**Reconciliation of the Statement of Revenues, Expenditures,  
and Changes in Fund Balances (Deficit) of Governmental  
Funds to the Statement of Activities  
For the Year Ended June 30, 2014**

Net Change in Fund Balances (Deficit) - Total Governmental Funds	\$ 1,443,504
Amounts reported for governmental activities in the Statement of Activities are different because:	
Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Position, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.	2,924,638
Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Position, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds.	(59,338)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	1,017,850
Revenues in the statement of revenues that correspond to the prior year resources are recorded as revenues in the statement of activities.	(95,216)
Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Position, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represented the change in accrued interest from prior year.	(57,855)
Construction in progress accounts payable.	469,532
Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide Statement of Net Position. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Position. This is the amount by which debt proceeds exceed the debt service principal payments.	(1,870,000)
Repayment of long-term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Position:	
General obligation bonds and notes	1,044,200
Other long-term liabilities	(964,276)
	<hr/>
Change in Net Position of Governmental Activities	<u>\$ 3,853,039</u>

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("USGAAP") as applicable to governmental units.

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

As part of this Statement, there is a reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement allows an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality elected to implement the retroactive capitalization of infrastructure assets.

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

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

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

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

On July 1, 2009, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which modified the interpretations of certain terms within the definition of the special revenue funds and the types of activities the Municipality may choose to report in those funds. GASB No. 54 also clarified the capital projects fund type definition for better alignment with the needs of preparers and users. Definitions of other governmental fund types were also modified for clarity and consistency.

The provisions of the GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, an amendment of Statements No. 14 and 34, were considered in the evaluation of the potential component units. This statement modifies certain requirements for inclusion of component units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government under certain circumstances.

The GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance included in FASB pronouncements, which does not conflict with or contradict GASB pronouncements, and eliminates the criteria to apply post November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements.

In current year, the Municipality adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and the Net Position* establishing a new statement of net position format that reports separately all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). The Statement requires deferred outflows of resources and deferred inflows of resources to be reported separately from assets and liabilities. The financial reporting impact resulting from the implementation of GASB 63 in the Municipality's financial statements was the renaming of "Net Assets" to "Net Position", including changing the name of the financial statement from "Statement of Net Assets" to "Statement of Net Position".

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

### A. Component units

In evaluating how to define the Municipality for financial reporting purposes, Management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASB Statement No. 14, as amended. The basic, but not the only criterion, for including a potential component unit within the reporting entity is if a primary government is financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such

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

that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the Municipality does not have component units to include within its reporting entity.

B. Government-wide and fund financial statements

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

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

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

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

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

**Housing Project Brisas de Arroyo Fund** – is a major governmental fund used to account for all the transactions of the HUD Housing Project. The primary objectives of this fund is to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operated under financing from U.S. Department of Agriculture Section 515 Rural Rental Housing Loans Program, and with Section 8 New Construction and Substantial Rehabilitation Program housing assistance grant agreement with HUD. For financial reporting purposes, the project is reported as part of the Municipality's operation because its purpose is to provide low-income housing to citizens of the Municipality.

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

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

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

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

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

### C. Financial reporting presentation

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

**General Fund** - General Fund is the general operating fund of the Municipality. It is used to account for all financial resources not accounted for and reported in another fund.

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

**Capital Projects Fund** - Capital Projects Funds are used to account for all financial resources restricted, committed or assigned to expenditure for the acquisition or construction of improvement of major capital facilities and other assets.

**Special Revenue Fund** - Special Revenue Funds are used to account and report the proceeds of specific revenue sources derived from state and federal grants that are restricted or committed to expenditure for specific purposes other than debt service or capital projects. The uses and limitations of each special revenue fund are specified by Municipal ordinances or federal and state statutes.

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

The outstanding balance of certain general long-term obligations for which debt service payments do not involve the advance accumulation of resources (such as certain notes payable, obligations under capital leases, accrued compensated absences, landfill obligation, claims and judgments, net pension liability and other long-term obligations) are only accounted for in the accompanying statement of net position. The debt service payments of such obligations are generally accounted for in the governmental fund which accounted for the financial resources used for the payment of such debts.

### D. Measurement focus, basis of accounting and financial presentation

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

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

The Municipality groups its non-exchange transactions into the following four (4) classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions. In the case of derived tax revenue transactions, which result from assessments that the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred (such as municipal license tax). In the case of imposed non-exchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on non-governmental entities, including individuals, other than assessments on exchange transaction, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license taxes are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used for the first fiscal year that the use of the resources is permitted.

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

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

For voluntary non-exchange transactions (such as donations and certain grants and entitlements) receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above.

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2014. Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

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

**Government Fund Financial Statements (GFFS)** – The accompanying GFFS are reported using the current financial resources measurements focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal licenses taxes, construction excise taxes, sales and use taxes, interests on deposits, intergovernmental grants and contributions and certain charges for services) to be available if collected within sixty (60) days after June 30, 2014. At June 30, 2014, all revenues sources met this availability criterion.

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

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

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

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange, exchange-like transactions are also generally recorded when the exchange takes place while all revenues, expenses, gains, losses, and assets resulting from non-exchange transactions are recorded when an enforceable legal claim arises or when all eligibility requirements imposed by the provider have been met, applicable. Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2014.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. The accompanying Balance Sheet – Governmental Funds generally reflects only assets that will be converted into cash to satisfy current liabilities.

Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying Balance Sheet – Governmental Funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying Balance Sheet – Governmental Funds.

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

### E. Assets, liabilities and net position

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

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

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

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

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

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represent the balance due from the Municipal Revenue Collection Center (CRIM) resulting from the final liquidations of advances made by CRIM to the Municipality corresponding to collections from property taxes and legislative appropriations from the Commonwealth of Puerto Rico plus final liquidation of contributions in lieu of taxes payable by the Puerto Rico Electric Power Authority (PREPA) to the Municipality. During the last years, the Puerto Rico Electric Power Authority has not been financially able to afford the cost of the Contribution in Lieu of Taxes as required by Section 22(b) of Act Number 83-1941, as amended. For those years, the Authority has recognized a partial credit for each year and has amortized the remaining amount owed during the three subsequent fiscal years. As of June 30, 2014, the Contribution in Lieu of Taxes corresponding to the Municipality of Arroyo amounted to \$850,349. Management anticipates that due to the serious financial limitations being encountered by PREPA, the remaining non-credited balance of such amount will be amortized during the fiscal years 2015 and 2016. Intergovernmental Receivables in the debt service fund represent 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 or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

During the beginning of fiscal year 2008-2009, the Municipality resolved the contract signed with the Secretary of the Treasury to collect and distribute the revenues produced by the sales and use tax. As part of the new organizational chart implemented for the Finance Directorate, a new unit was created under such directorate which has been responsible to manage this function at the Municipality's level. Such decision has been beneficial for the Municipality in its search for additional increases in current revenues derived from such tax.

3. **Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net position.
4. **Capital assets-** Capital assets include land and land improvements, buildings, structures and building improvements, machinery and equipment (including equipment held under capital leases), furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. The Municipality defines capital assets as assets with an initial, individual cost of more than \$500 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

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

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

<u>Description</u>	<u>Useful Life</u>
Land Improvements	20 years
Buildings, structures and building improvements	30 to 50 years
Infrastructure	20 to 50 years
Motor Vehicles	5 years
Furniture and fixtures	5 to 20 years
Machinery and equipment	5 to 20 years
Equipment held under capital leases	3 to 5 years

5. **Unearned revenues-** In the GFFS, unearned revenues arises when:

- a. The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for unearned revenue is removed and revenue is recognized.

6. **Long-term obligations-** The liabilities reported in the government-wide financial statements include 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 costs, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures

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

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

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

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

9. **Fund Balances** – On July 1, 2009, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy upon the use of the resources reported in governmental funds.

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

- a. **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). These, restrictions may be changed or lifted only with the consent of resource providers.
- b. **Committed** – Represent resources used for specific purposes, imposed by formal action of the Municipality's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.
- c. **Assigned** – Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- d. **Unassigned** – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Negative fund balance amounts are assigned amounts reduced to the amount that will raise the fund balance to zero. Consequently, negative residual amounts in restricted, committed and assigned fund balance classifications have been reclassified to unassigned fund balances.

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, 2014.

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

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

10. **Net position** - Net position has been reported pursuant to the provisions of GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. Net Position represents the difference between all assets plus deferred outflows of resources and all liabilities plus deferred inflows of resources. The Net Position consists of net resources restricted by external parties (such as debt covenants, creditors, grantors, contributions, laws or regulations of other governments, ect.) or net position for which constraints are imposed by the constitutional provisions or enabling legislation.

Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

A legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. The Municipality periodically reevaluates the legal enforceability of an enabling legislation to determine if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration.

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

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

In the government-wide statements, net position is segregated into three categories:

- a. **Net investment in capital assets:** Represents the component of the net position that consist of capital asset balances, net of accumulated depreciation, and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds).
- b. **Restricted net position:** Represents the component of the net position that is subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

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

c. **Unrestricted net position:** Represents the component of the net position that does not meet the definition of net investment in capital assets or restricted. Unrestricted assets are often designated to indicate that Management does not consider them to be available for general operations. These types of constraints are internal and Management can remove or modify them. Designations are not reported on the face of the statement of net position.

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

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

For the purpose of applying the requirements of GASBS No. 27, the state Government of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Government of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government of Puerto Rico.

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

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

**13. Risk financing-** The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico. Under Act No. 63 of June 21, 2010, the Legislative Assembly of the Commonwealth of Puerto Rico, authorized the municipalities to procure and manage at their own discretion all insurance policies, including those related to health plans being provided to the municipal employees. The Municipality obtains medical insurance from a health insurance company for its employees. Different health coverage and premium options are negotiated each year by the Municipality. Premiums are paid on a monthly basis directly to the insurance company.

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, 2014 amounted to \$238,685.

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

The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$166,148 for workers compensation insurance covering all municipal employees.

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

## 2. CASH AND CASH EQUIVALENTS

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

On July 1, 2005, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

**Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2014.

**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, 2014, (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, 2014, 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, 2014, 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.

## 2. CASH AND CASH EQUIVALENTS (CONTINUED)

In addition, public funds deposited in commercial banks are fully collateralized for the amounts deposit in excess of the federal depository insurance. All securities pledged as collateral are held, in the Municipality's name, by the Commonwealth's Secretary of Treasury Deposits with GDB are unassured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2014. Therefore, the Municipality's management has concluded that at June 30, 2014, 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, 2014.

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

**Deposits** - The Municipality's bank balances in commercial banks of approximately \$39,709 and \$2,175,971 in the Housing Project Brisas de Arroyo Fund and the Other Governmental Funds, respectively, were fully collateralized at June 30, 2014. In addition, the Housing Project Fund maintained \$646,706 of restricted cash. The General Fund presents a bank overdraft of \$181,993, at June 30, 2014.

The deposits at GDB of approximately \$39,321 that are restricted for other purposes reported in the General Fund, the \$1,595,559 in the Debt Service Fund and \$1,405,990 in the Other Governmental Funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

## 3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES

**A. Property taxes** - Property taxes receivable recorded in the Debt Service Fund amounted to \$5,442.

**B. 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 Act 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 \$3,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2014, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations- 0.50% of gross revenues

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES (CONTINUED)

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, 2014, net of allowance for uncollectible accounts. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as unearned revenues.

- C. **Municipal sales and use tax** – The Municipality imposes a sales and use tax within the territorial limits of the Municipality pursuant to the Internal Revenue Code of the Government of Puerto Rico. This is a self-assed tax consisting of one and half percent (1.5%) on the sale price of a taxable item or on the purchase price of all usage or consumption of a taxable item. It is collected monthly in a tax return that is due twenty calendar days after the end of each month. 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 (.1%), the Municipal Redemption Fund (.3%) and the Municipal Improvements Fund (.1%) with the remaining 0.5%.

A portion of the sales tax amounting 0.2% is restricted for the payment of long-term debt and is recorded in the debt service fund. The remaining portion of the 1.5% is recorded in the general fund since is available for general operating purposes.

Sale tax receivable represents sales tax levied that were collected subsequent to June 30, 2014, but pertaining to current year period. At June 30, 2014, the sales and use taxes receivable amounted to \$68,336 and \$140,058 in the general fund and debt service fund, respectively.

- D. **Due from Commonwealth Government** - In the General Fund, Intergovernmental receivable represents expenditures incurred not yet reimbursed by other governmental entities. Following is a detail of the intergovernmental receivable:

<u>Governmental Entity</u>	<u>Amount</u>
P.R. Treasury Department	\$ 58,657
P.R. Electric Power Authority	<u>850,349</u>
<b>Total</b>	<b><u>\$ 909,006</u></b>

<u>Governmental Entity</u>	<u>Amount</u>
P.R. Department of Labor- Law 52	\$ 195,909
P.R. Treasury Department	<u>121,260</u>
<b>Total</b>	<b><u>\$ 317,169</u></b>

3. RECEIVABLES AND DUE FROM GOVERNMENTAL ENTITIES (CONTINUED)

E. *Due from Federal Government* - Federal Government receivables represents expenditures incurred not yet reimbursed by the Federal Government or the pass-through grantors. Following is a detail of amounts included in this item:

<u>Federal Program Description</u>	<u>Amount</u>
Community Development Block Grant – State's Program	\$ 87,673
Community Service Block Grant	9,832
Homeland Security Grant	48,858
Others	4,502
<b>Total</b>	<b><u>\$ 150,865</u></b>

F. Miscellaneous receivables in the General Fund amounting \$111,384, represent from the solid waste management services invoices billed and not received at June 30, 2014.

4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2014, and interfund transfers during the fiscal year ended at June 30, 2014, are summarized as follows:

a. Due from/to other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Other Governmental Funds	Reimbursable expenditures	\$1,011,581
Other Governmental Funds	General Fund	Reimbursable expenditures	398,063
<b>Total</b>			<b><u>\$1,409,644</u></b>

b. Transfer in/out to other funds:

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt retirement	\$ 33,900
General Fund	Other Governmental Funds	Transfer of funds or operational activities	133,483
Debt Service Fund	Other Governmental Funds	Transfer of funds or operational activities	1,142,748
<b>Total</b>			<b><u>\$ 1,310,131</u></b>

**5. CAPITAL ASSETS**

Capital assets, those with an estimated useful life of one year or more from the time of acquisition by the Municipality and a cost of \$500 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2014, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

<u>Governmental Activities:</u>	<u>Balance July 1, 2013</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2014</u>
Capital assets, not being depreciated:				
Land	\$ 9,705,674	\$ -	\$ -	\$ 9,705,674
Construction in progress	1,518,524	188,815	-	1,707,339
Work of art	3,410	-	-	3,410
Land- Housing Project	<u>595,000</u>	<u>-</u>	<u>-</u>	<u>595,000</u>
Total capital assets not being depreciated	<u>11,822,608</u>	<u>188,815</u>	<u>-</u>	<u>12,011,423</u>
Capital assets, being depreciated:				
Buildings structures and building improvements	24,189,608	202,658	-	24,392,266
Infrastructure	10,723,459	128,767	-	10,852,226
Vehicles, machinery and equipment	2,256,606	210,978	-	2,467,584
Furniture and fixtures	1,464,687	-	-	1,464,687
Building and equipment- Housing Project	<u>3,768,783</u>	<u>10,710</u>	<u>-</u>	<u>3,779,493</u>
Total capital assets being depreciated	<u>42,403,143</u>	<u>553,113</u>	<u>-</u>	<u>42,956,256</u>
Less accumulated depreciation for:				
Buildings structures and building improvements	(9,577,911)	(2,033)	-	(9,579,944)
Infrastructure	(3,798,112)	(55,741)	-	(3,853,853)
Vehicles, machinery and equipment	(2,256,606)	(20,407)	-	(2,277,013)
Furniture and fixtures	(1,316,435)	-	-	(1,316,435)
Building and equipment- Housing Project	<u>(3,135,275)</u>	<u>(102,466)</u>	<u>-</u>	<u>(3,237,741)</u>
Total accumulated depreciation	<u>(20,084,339)</u>	<u>(180,647)</u>	<u>-</u>	<u>(20,264,986)</u>
Total capital assets being depreciated, net	<u>22,318,804</u>	<u>372,466</u>	<u>-</u>	<u>22,691,270</u>
<b>Governmental activities capital assets, net</b>	<b><u>\$ 34,141,412</u></b>	<b><u>\$ 561,281</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 34,702,693</u></b>

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

<u>Governmental activities:</u>	<u>Amount</u>
General government	\$ 792
Urban development	60,375
Public safety	4,580
Culture & recreation	4,103
Human services & welfare	<u>110,797</u>
<b>Total depreciation expense-governmental activities</b>	<b><u>\$ 180,647</u></b>

**6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities at June 30, 2014 are summarized as follows:

<u>Description</u>	<u>General Fund</u>	<u>Brisas de Arroyo Fund</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Accounts payable	\$ 355,551	\$ 41,312	\$ 105,623	\$ 502,486
Accrued liabilities	236,054	-	-	236,054
<b>Total</b>	<b>\$ 591,605</b>	<b>\$ 41,312</b>	<b>\$ 105,623</b>	<b>\$ 738,540</b>

**7. DUE TO OTHER GOVERNMENTAL ENTITIES**

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

<u>Governmental Entity</u>	<u>Amount</u>
P.R. Aqueduct and Sewer Authority	\$ 320,377
Retirement System Administration	94,236
P.R. Department of Labor	26,870
General Services Administration	12,104
<b>Total</b>	<b>\$ 453,587</b>

The due to governmental units in the Other Governmental Funds amounting to \$76,287, represents advances made to the Child Care Development Block Grant, that will be remitted to the Pass-through entity once the closing is made.

**8. UNEARNED REVENUES**

**A. Municipal License Tax-** The unearned revenues of \$964,961 in the general fund relates to municipal license tax collected in fiscal year 2013-14 that will be earned in fiscal year 2014-15.

**B. Federal Government-** The unearned revenues presented in the other governmental funds represent the portion of federal grants received for which qualifying expenditures have not been incurred. Unearned revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Child Care Food Program	\$ 2,547
Disaster Grants – Public Assistance	233,430
Others	3,717
<b>Total</b>	<b>\$ 239,694</b>

**8. DEFERRED INFLOWS OF RESOURCES – GOVERNMENTAL FUNDS**

As required by current standards, revenues and other governmental fund financial resources should be recognized in the accounting period in which they become both measurable and available. When an asset is recorded in governmental funds' financial statements but the revenue is not available, the Municipality should report a deferred inflow of resources until such time as the revenue becomes available. A detail of these balances follows:

<u>Major fund - General fund:</u>	<u>Inter- governmental</u>
P.R. Department of Treasury – Christmas bonus reimbursement	\$ 58,657
P.R. Electric Power Authority (PREPA)	850,349
	<u>\$ 909,006</u>

**9. PROPERTY TAXES**

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

The CRIM is required by law to prepare a liquidation 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, subject to the verification by its Independent Auditors. 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. For the fiscal year ended June 30, 2014, the CRIM issued the final liquidation reporting that collections exceeded advances by \$96,006.

## 9. PROPERTY TAXES (CONTINUED)

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. The Statement of Net Position includes an outstanding debt balance of \$1,979,494 at June 30, 2014 related with Law No. 42.

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 through a 30-year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law. During the first five years of the note, commenced in July 1, 2003, the Municipality shall pay only interest. At the end of the first five years of the note, the repayment terms and conditions of the note shall be renegotiated to allow the Municipality to pay the outstanding balance of the note in equal installments of principal plus interest, through maturity. The Statement of Net Position includes an outstanding debt balance of \$438,968 related to Law No. 146.

**9. PROPERTY TAXES (CONTINUED)**

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.

**10. LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2014, was as follows:

<u>Description</u>	<u>Beginning Balance, as restated</u>	<u>Borrowings or Additions</u>	<u>Payments or Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable	\$ 10,030,000	\$ -	\$ ( 425,000)	\$ 9,605,000	\$ 455,000
Public Act No. 42 January 20, 2001	2,035,554		(56,060)	1,979,494	59,583
Public Act No. 146 of October 11, 2001	463,405		(24,437)	438,968	24,387
Claims and judgments Section 515 Loan Program	153,422	15,139	(153,422)	15,139	
Landfill closure and post-closure care costs	1,776,998		(52,958)	1,724,040	57,469
System Retirement Administration-	1,694,062			1,694,062	
Repayment Plan	134,623		(85,020)	49,603	49,603
Christmas Bonus	96,610	126,288	(96,610)	126,288	126,288
Compensated absences	1,460,826	25,786		1,486,612	150,000
P.R. Department of Labor- Repayment Plan		514,591	(66,522)	448,069	102,132
CRIM- Final Settlement 2013-2014		96,006		96,006	96,006
P.R. Electric Power Authority	493,046	357,303		850,349	502,196
<b>Total</b>	<b>\$ 18,338,546</b>	<b>\$ 1,135,113</b>	<b>\$ ( 960,029)</b>	<b>\$ 18,513,630</b>	<b>\$ 1,622,664</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 and notes payable, is paid with unrestricted funds.

10. LONG-TERM LIABILITIES

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

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

As describe in **Note 9** the Municipality levies an annual additional special tax of 4.00 percent of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's Debt Service Fund.

For financial reporting purposes the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2014:

Description	Balance at June 30, 2014
2002 General bond obligation for construction and improvement of infrastructure assets with an original amount \$1,410,000 due in installments of \$20,000 to \$125,000 through July 1, 2026, with interest of 5.0%	\$ 1,045,000
2002 General obligation bond for operational purposes with an original amount of \$940,000 due in installments of \$10,000 to \$80,000 through July 1, 2026, with interest of 7.5%	695,000
2007 General obligation bond for construction and improvements of infrastructure with an original amount of \$1,250,000 due in installments of \$20,000 to \$105,000 through July 1, 2031, with interest of 7.0%	1,075,000
2010 General obligation bond for construction and improvements of infrastructure with an original amount of \$1,355,00 due in installments of \$55,000 to \$140,000 through July 1, 2024, with interest of 7.0%	1,115,000
2010 General obligation bond for construction and improvements of infrastructure with an original amount of \$515,000 due in installments of \$110,000 through July 1, 2015, with interest of 5.0%.	115,000
2010 General obligation bond for operational debts payment with an original amount of \$135,000 due in installments of \$25,000 to \$30,000, through July 1, 2015, with interest of 7.0%	30,000
2009 General obligation bond for construction and improvement of infrastructure assets with an original amount of \$4,640,000 due in installments of \$70,000 to \$385,000, through July 1, 2033, with interest of 7.5%	4,240,000
2011 General obligation bond for operational purposes with an original amount \$1,910,000 due in installments of \$15,000 to \$110,000 through July 1, 2035, with interest ranging from 6.0% to 7.5%	1,290,000
<b>Total general obligation bonds</b>	<b>\$ 9,605,000</b>

**10. LONG-TERM LIABILITIES (CONTINUED)**

These bonds and notes, except the \$135,000 bond, are payable from the special ad valorem property tax of 4.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. The before detailed bond is payable with General Fund resources. The bonds and notes amounting \$4,640,000 and \$1,315,000 are payable with the revenues generated from the collection of the .2% of the municipal sales and use tax imposed by the Municipality and collected by the Commonwealth of Puerto Rico Treasury Department.

**10. LONG-TERM LIABILITIES (CONTINUED)**

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

<u>Year Ending June 30, 2014</u>	<u>Principal</u>	<u>Interest</u>
2015	\$ 455,000	\$ 294,210
2016	325,000	591,137
2017	355,000	570,137
2018	375,000	547,675
2019	410,000	523,575
2020-2024	2,545,000	2,188,575
2025-2029	2,535,000	1,357,962
2030-2034	2,390,000	527,687
2035-2039	215,000	16,312
<b>Total</b>	<b>\$ 9,605,000</b>	<b>\$ 6,617,270</b>

- C. Property Taxes Debts (Law No. 146 and Law No. 42)-** These amounts represents the balance owed to the Municipal Revenue Collection Center ("CRIM") at June 30, 2014 as described in Note 9.
- D. Compensated absences-** The government-wide statement of net position includes approximately \$492,985 of accrued sick leave benefits, and approximately \$993,627 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.
- E. Landfill closure and post-closure care costs -** State and federal laws and regulations require the Municipality to place a final cover on its landfill site, when it stopped accepting waste, and perform certain maintenance and monitoring functions at the site for 30 years after closure. GASB statement No. 18 of "Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs," 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. The Municipality has not performed such a study but has recognized \$1,694,062 as an estimated current cost for landfill post-closure cares costs as of June 30, 2014. Actual costs may be different once a study has been made as per the required regulations and due to inflation, changes in technology, or changes in laws and regulations. The balance of post-closure costs is reported in the government-wide statement of net position
- F. Department of Labor repayment plans –** These amounts represent the balance owed to the Department of Labor related with unemployment compensation.

10. LONG-TERM LIABILITIES (CONTINUED)

- G. **Claims and judgments** – Represents the estimated loss of legal cases to be paid subsequent to June 30, 2014. The awarded amount, if any, will be paid with unrestricted funds.
- H. **Employees Retirement Administration repayment plan** – These amounts represent the balance owed to the Administration related with payroll retentions and fringe benefits.
- I. **Section 515 Rural Rental Housing Loan Program** – Two mortgages notes, collateralized with land and buildings of Housing Project Brisas de Arroyo, payable to Rural Development of the U.S. Department of Agriculture, in monthly installments of \$12,892 and \$1,994, including interest at an annual rate of 8% (reduced to 7%) and 10% (reduced to 9%) through December 2029. This amount represents the balance of a debt repayment agreement with the Authority at June 30, 2014.
- J. **CRIM- Final Settlement 2013-2014** – For the fiscal year ended, June 30, 2014 the CRIM notified the Municipality that the final settlement of property tax advances versus actual collections through fiscal year 2014 resulted in an overpayment to the Municipality of \$96,006.
- K. **Christmas Bonus** – represents the accrued portion corresponding to the fiscal year 2014 of the Christmas bonus to be paid in December 2014. The outstanding amount is \$126,288.
- L. **P.R. Electric Power Authority** – As required by Act No. 83 of May 2, 1941, the Puerto Rico Electric Power Authority ("PREPA") should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax ("CELI") based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For fiscal year 2013, the Municipality's annual energy charges amounted to \$1,218,077 but the CELI obligation amounted to \$823,420. The excess amount of \$1,693,470 was recorded as a payable and a receivable for the same amount and will be amortized over a three-year period. As of June 30, 2014 the outstanding amount of \$1,301,519 includes the unamortized balances of \$969,614 and \$723,856 from fiscal years 2013 and 2012, respectively, and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:

<u>June 30</u>	<u>Principal</u>
2015	\$ 969,614
2016	<u>723,856</u>
<b>Total</b>	<b><u>\$ 1,301,519</u></b>

## 11. PENSION PLAN

### A. Act 447 and System 2000 (until June 30, 2013)

As of June 30, 2014 regular employees of the Municipality contribute to a cost-sharing multiple employer defined benefit retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full-time public employees working for

the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

## 11. PENSION PLAN (CONTINUED)

The system operates under *Act 447, approved on May 15, 1951* effective on January 1, 1952 and *Act 1 of February 16, 1990* for employees that entered as participants of the Plan starting April 1, 1990 and ending December 31, 1999. Under this Act, retirement benefits were determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation was computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member was eligible, was limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

*Act No. 305 of September 24, 1999* amended *Act No. 447 of 1951* and *Act 1 of February 16, 1990* to establish a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the Act 447 system as of December 31, 1999 had the choice to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 were only allowed to become members of the new program. System 2000 was a hybrid defined contribution plan, also known as a cash balance plan.

There would be a pool of pension assets, which would be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age would not be guaranteed by the State government and would be subjected to the total accumulated balance of the savings account. The annuity would be based on a formula, which assumed that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) would be invested in an account which would 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 System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If the savings accounts balance was \$10,000 or less at time of retirement, the balance would be distributed by the System to the participant as a lump sum. Participants received periodic account statements similar to those of defined contribution plans showing their accrued balances. The employer contributions (11.275% of the employee's salary) would be used to fund the plan. Under System 2000 the retirement age was reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

The Act 447, as amended, was the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities were established or amended. Plan members were required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributed 8.275% of gross salary. In order to address the unfunded actuarial accrued liability of the System, on July 6, 2011 (effective July 1, 2011) the Commonwealth Legislature approved Act No. 116 increasing the employers' contributions rate from 9.275% to 10.275% of employee compensation for fiscal year 2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The purpose of this Act was to provide cash flow and strength the System to adequately cover administrative expenses and payment of benefits. The Municipality was required to contribute 11.275% of gross salary until the fiscal year ended on June 30, 2013. As stated in the Act, percent increases applicable to municipalities for fiscal years 2011-2012, 2012-2013 y 2013-2014 would be financed through the Commonwealth's budget approved by the Commonwealth's Legislature.

**B. Act 3 of 2013 (beginning July 1, 2013)**

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3 of 2013, representing a comprehensive reform of the ERS. Act No. 3 became effective on July 1, 2013 and amends the provisions of the different benefits structures under the ERS, including, but not limited to, the following:

- All participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) were moved to a new hybrid plan ("New Plan").
- For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 were frozen. Thereafter, all future benefits will accrue under the New Plan. Participants will receive a pension at retirement age equivalent to what they had accrued under Act 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.
- Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual's life expectancy and a rate of return.
- New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees' contributions plus a return on investment)
- Eliminated the possibility of accruing a merit pension (payable once the participant had achieved 30 years of creditable service) after June 30, 2013.
- Increased employee contributions from 8.275% to a minimum of 10.000%.
- After July 1, 2013 all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016 an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. These contributions will be used to increase the System's assets, reduce the actuarial deficit and enable the System to comply with future obligations.

**11. PENSION PLAN (CONTINUED)**

- Retirement age was modified as follows:
  - ✓ Act 447 regular employees: age 58 to 61,
  - ✓ Act 447 high risk employees (state and municipal police, firefighters and custody officials): from age 50 to 55 years,
  - ✓ Act 305 (System 2000) regular employees: age 60 to 65; high risk employees remains the same (55 years).

Act 1 employees remained the same (65 years for regular employees and 55 for high risk employees. For new employees under the New Plan will retire after 67 years (retirement age will be 67 for regular employees and 58 for high risk employees).

- Due to changes to Special Laws (see note 14), the minimum monthly pension for current retirees was increased from \$400 to \$500.
- Disability benefits were eliminated and substituted for a mandatory disability insurance policy. Beginning July 1, 2013, each employee must contribute to this insurance plan .25% of his or her monthly salary, up to a monthly maximum of \$5,000. Therefore, the maximum monthly employee contribution will be \$12.50 (\$5,000 x .25%).
- Survivor benefits were modified.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

<u>Fiscal year ended:</u>	<u>Law No. 447</u>	<u>System 2000</u>	<u>Law No. 3</u>
2014	\$ -	\$ -	\$ 305,501
2013	\$ 176,768	\$ 54,914	\$ -
2012	\$ 375,179	\$ 298,287	\$ -

**A. Act 32 of 2013 (beginning July 1, 2013)**

On June 25, 2013, Act 32 was approved in order to amend Act 447 of 1957 by creating a new Article 5-117 *Additional Uniform Contribution (AUC)*, with the purpose of solving the cash flow deficit of the System. For each fiscal year, beginning on July 1, 2013, the ERS will: 1) determine the portion of the AUC attributable to each participating employer based on the percentage each employer's contributions represent of the total employer contributions established for that fiscal year; and 2) send to the director of the P.R. Office of Management and Budget (OMB) and to each public corporation and municipality whose employees are covered by this Act, a certification of the AUC owed by each employer.

## 11. PENSION PLAN (CONTINUED)

Act 32 defines the concept of the AUC as follows:

- For the fiscal year 2013-2014, the AUC will be one hundred and forty million dollars (\$140,000,000)
- For each subsequent fiscal year, beginning with the 2014-2015 fiscal year until 2032-2033, the AUC will be the contribution certified by the external actuary of the System, at least 120 days prior to the beginning of each fiscal year, deemed necessary to prevent that the value of the System's projected gross assets, during any subsequent fiscal year, be lower than one thousand million dollars (\$1,000,000,000). If, for any fiscal, the certified AUD is not available within the 120-day period prior to the beginning of the said fiscal year or within a shorter term with the consent of the OMB, the AUC will be equal to the contribution certified for the immediate preceding fiscal year.

Each public corporation and municipality covered by this Act is directly responsible for the payment of their corresponding certified AUC. However, for any fiscal year, the OMB will consign in the Commonwealth's General Budget enough resources to subsidy totally or partially the AUC certified to any public corporation, municipality or governmental entity, including the Judiciary Branch, whose operating expenditures are not fully or partially covered by the General Budget and for which the OMB, has subsequently determined it does not have the financial capacity to assume such obligation during the fiscal year.

For the fiscal year 2013-2014, \$41.142 million dollars were assigned to OMB through Commonwealth Legislative Resolution of Special Assignments No. 17 (RC 17-2013) for the total or partial subsidy of the AUC of any public corporation or municipality that the agency determined did not have the financial capacity to assume this obligation. The OMB's evaluation of a municipality's financial capacity was based on two parameters: financial indicators and population. The financial indicators to be evaluated were: profitability index (net income as a percentage of revenues); capital ratio (the proportion between the net position of the entity and the AUC) and debt margin ratio (the proportion between the AUC and the municipality's special ad valorem tax debt margin (CAE)).

## 12. POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 16, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas and summer bonuses and death benefits.

## **12. POSTEMPLOYMENT BENEFITS (CONTINUED)**

However, beginning July 1, 2013, Act 3 of 2013 modified these Special Laws benefits as follows:

- Reduction in the Christmas bonus from \$600 to \$200 (current retirees),
- Elimination of summer bonus of \$100 (current retirees),
- No change in medical plan contribution of up to \$1,200 and medicine bonus of \$100 (current retirees)
- Eliminated all Special Law benefits to future retirees.

Act 3 also established that employers will contribute \$2,000 per for each retiree that began working for the government on or before December 31, 1999. This contribution was established based on the assumption that the System will benefit from the savings generated between this employer contribution and the Special Law benefits paid out to retirees.

For the fiscal year 2013-2014, \$20 million dollars were assigned to OMB through Commonwealth Legislative Resolution of Special Assignments No. 17 (RC 17-2013) for the total or partial subsidy of net incremental cost of the \$2,000 contribution per retiree for any municipality that the agency determined did not have the financial capacity to assume this obligation. The OMB's evaluation of a municipality's financial capacity was based on the same two parameters evaluated for the Additional Uniform Contribution (AUC) subsidy (financial indicators and population). For the fiscal year ended June 30, 2014, the subsidy received from OMB was \$156,600, which partially covered the costs related to these post-employment benefits of \$416,302. These benefits are recorded as expenditures in the general fund.

## **13. RISK MANAGEMENT**

The Property Division, attached to the Municipality, is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three (3) fiscal years.

## **14. COMMITMENTS AND CONTINGENCIES**

The Municipality has reported outstanding encumbrances amounting to \$155,314 in the General Fund at June 30, 2014. The Municipality intends to honor these encumbrances which will continue to be liquidate under the current year's budget during a lapse period that extends into the fiscal year.

15. FUND BALANCE (DEFICIT)

As of June 30, 2014, fund balance (deficit) is comprised of the following:

	General Fund	Brisas de Arroyo Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
<b>Restricted</b>					
General government	\$ 39,321	\$ -	\$ -	\$ -	\$ 39,321
Public safety				104,414	104,414
Public works				120,345	120,345
Culture and recreation				3,715	3,715
Human service & welfare		634,770		287,921	922,691
Urban development				2,493,976	2,493,976
Debt service			1,068,230		1,068,230
<b>Unassigned</b>	<u>(1,369,458)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,369,458)</u>
<b>Total fund balances (deficit)</b>	<u><u>\$ (1,330,137)</u></u>	<u><u>\$ 634,770</u></u>	<u><u>\$ 1,068,230</u></u>	<u><u>\$ 3,010,371</u></u>	<u><u>\$ 3,383,234</u></u>

16. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The GASB has issued the following statements that have effective dates after June 30, 2014:

- ❖ GASB Statement No. 68 *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This statement is effective for periods beginning after June 15, 2014. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities.
- ❖ GASB Statement No. 69 *Government Combinations and Disposals of Government Operations*. The requirements of this statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions and transfers of operations.
- ❖ GASB Statement No. 70 *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This statement is effective for periods beginning after June 15, 2013. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

**16. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

- ❖ GASB Statement No. 71 *Pension Transition for Contributions made Subsequent to the Measurement Date- an amendment of GASB 68*. This statement is effective for periods beginning after June 15, 2014. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68.

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

**17. PRIOR PERIOD ADJUSTMENTS**

**A. GOVERNMENTAL FUND FINANCIAL STATEMENTS**

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

<u>Description</u>	<u>General Fund</u>	<u>Other Governmental Funds</u>
Fund balance (deficit), beginning	\$ (591,038)	\$ 178,894
<u>Correction of errors:</u>		
Understatement of due from other funds	124,707	
Overstatement of accounts payable- suppliers	392,448	
Understatement of due to governmental units	(108,364)	
Recognition of funds as per GASB 54	(600,349)	600,349
Overstatement of due to other funds	-	261,809
Fund balance (deficit), beginning, as restated	<u>\$ (782,596)</u>	<u>\$ 1,041,052</u>

17. PRIOR PERIOD ADJUSTMENTS (CONTINUED)

B. GOVERNMENT WIDE FINANCIAL STATEMENTS

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

<u>Description</u>	<u>Governmental Activities</u>
Net position – beginning	\$ 18,382,957
Understatement of due from other funds	124,707
Overstatement of accounts payable- suppliers	392,448
Understatement of due to governmental units	(108,364)
Overstatement of due to other funds	261,809
Adjustment to Infrastructure assets	484,895
Adjustment to net position of federal grants	(69,489)
Net position - beginning, as restated	<u>\$ 19,468,963</u>

18. SUBSEQUENT EVENTS

Implementation of Acts 18 and 19 of 2014

The dispositions established by Acts 18 and 19 of 2014 related to the municipal sales and use tax became effective on July 1, 2014 (see note 3). The most significant changes are the creation of the Municipal Finance Corporation (COFIM) and, for the municipalities covered by these Acts, the new collection method of the 1% municipal sales and use tax and the establishment of a monthly advances system for the transfers of the .2% destined for the Municipal Development Fund (FDM) and of the .2% related to the Municipal Redemption Fund (FRM).

For those municipalities that signed the agreement to be covered by these Acts (including the Municipality of Arroyo), the transfers to be made by the Governmental Development Bank (GDB) of the .2% destined for the FDM and of the .2% related to the FRM will be based on a system of monthly advances: each month the GDB will make the FDM and FRM transfers based on the amounts collected that same month in the preceding fiscal year (2013-2014). At the end of the year, a settlement will be made comparing the actual collections of the FDM and FRM with the monthly advances made to each municipality.

If actual collections exceed the total advances received, an account receivable from GDB will be recognized; if actual collections are less than the total advances, a payable to the GDB will be recognized and amortized through withholdings from future advances. For municipalities not covered by these Acts, the monthly transfers will be made based on actual collections.

#### 18. SUBSEQUENT EVENT (CONTINUED)

As stated in Act No. 19, the 1% corresponding to the municipalities' sales and use tax will be deposited in COFIM. From these funds COFIM will deposit to the COFIM's sinking fund the greater of: .3% of the 1% municipal sales and use tax or an Annual Rental Fee (RFA). The RFA for fiscal year 2014-2015 will be \$65,541,281 and, thereafter, 1.5% of the RFA of the preceding fiscal period. The excess of the required deposit to the COFIM's sinking fund (.7% of the 1% of the municipal sales and use tax) will be transferred to the general fund of municipalities covered by the agreement or to the FRM as decided by the municipality. Before the transfer of the .7% to the municipalities covered by the Act, COFIM will transfer the 1% municipal sales and use tax to the municipalities not covered by the Act.

On September 1, 2014, the sixteen municipalities that collect their sales and use tax through the P.R. Department of Treasury (Aguadilla, Aibonito, Arroyo, Barranquitas, Ciales, Culebra, Hatillo, Juncos, Lajas, Lares, Maricao, Maunabo, Naguabo, Patillas, Peñuelas and Rincon) began participating on a pilot program for the collection of the 1% municipal sales and use tax through COFIM. In this program, a standard monthly sales and use tax return was created to be used by the retailers of these municipalities. The monthly returns were filed in the bank branches of the financial institution designated by COFIM to be its intermediary, the Popular Bank of Puerto Rico (BPPR). BPPR would electronically process the returns and submit their data to COFIM. However, beginning November 1, 2014, the retailers also had the option of using COFIM's internet portal to electronically file and pay the return.

On the other hand, the Governing Board of COFIM has not established an implementation date for the remaining 62 municipalities. However, for those municipalities that voluntarily decided to use COFIM's internet portal or collection process through the BPPR, their implementation date was December 1, 2014. For those municipalities that want to be certified as collection agents for COFIM, the implementation date is January 1, 2015. As collection agents for COFIM, the retailers of these municipalities have the option of filing and paying the monthly sales and use tax in the municipality's Collection Office. The Collection Office's personnel have the responsibility to deposit the daily sales and use tax collections in the bank account designated by COFIM, and also submit electronically the returns' data to the agency for processing in COFIM's data base. The Municipality of Arroyo has submitted the application to be a certified collection agent and is awaiting approval from COFIM.

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ARROYO**

**Budgetary Comparison  
Schedule- General Fund  
For the Fiscal Year June 30, 2014**

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>REVENUES::</b>				
Property taxes	\$ 1,335,734	\$ 1,335,734	\$ 1,335,734	\$ -
Municipal license taxes	1,243,550	1,243,550	1,071,583	(171,967)
Sales taxes	865,000	865,000	643,512	(221,488)
Intergovernmental	5,883,430	5,883,430	6,151,882	268,452
Construction excise taxes	250,000	250,000	112,601	(137,399)
Rent	108,200	108,200	63,209	(44,991)
Miscellaneous	216,000	448,000	652,977	204,977
<b>Total revenues</b>	<b>9,901,914</b>	<b>10,133,914</b>	<b>10,031,498</b>	<b>(102,416)</b>
<b>EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:</b>				
Mayor and municipal legislature	1,495,832	1,558,459	1,560,696	(2,237)
General government	3,891,457	3,936,572	4,051,540	(114,968)
Public safety	484,777	411,284	355,017	56,267
Public work	1,748,486	2,035,121	1,922,714	112,407
Culture and recreation	939,952	859,784	808,300	51,484
Sanitation	516,749	516,749	513,405	3,344
Human services and welfare	790,461	781,745	746,611	35,134
Operating transfer out and other financing uses	34,200	34,200	33,900	300
<b>Total expenditures, encumbrances and other financing uses</b>	<b>9,901,914</b>	<b>10,133,914</b>	<b>9,992,183</b>	<b>141,731</b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 39,315</b>	<b>\$ 39,315</b>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of resources:</b>				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$10,031,498
Differences-budget to GAAP:				
GAAP adjustments to revenues				748,398
<b>Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances</b>				<b>\$10,779,896</b>
<b>Uses/outflows of resources:</b>				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$9,992,183
Differences-budget to GAAP:				
Non-budgeted expenditures				949,646
Prior year encumbrances recorded as current year expenditures for GAAP basis				407,439
Current year encumbrances recorded as expenditures for budgetary purposes				(155,314)
Nonbudgeted transfer-out				(33,900)
<b>Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances</b>				<b>\$11,160,054</b>

See notes to the Budgetary Comparison Schedule-General Fund.

## 1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

### **Budgetary Control**

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2014 representing the Municipality's original budget. There were no supplemental appropriations for the year ended June 30, 2014.

<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>\$23,084</u>
<b>Total U.S. Department of Agriculture</b>			<u><b>\$23,084</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	N/A	604,970
Direct Program:			
Section 8 Housing Choice Voucher Program			
	14.871	N/A	459,556
Pass-through the Commonwealth of Puerto Rico – Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants – State's Program			
	14.228	Not Available	<u>349,240</u>
<b>Total U.S. Department of Housing and Urban Development</b>			<u><b>1,413,766</b></u>
<b>U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:</b>			
Pass-through the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN):			
Community Services Block Grant	93.569	Not Available	9,832
Child Care and Development Block Grant	93.575	Not Available	<u>275,068</u>
<b>Total U.S. Department of Health and Human Services</b>			<u><b>284,900</b></u>

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Expenditures
<b>U.S. DEPARTMENT OF HOMELAND SECURITY:</b>			
Pass-through the Commonwealth of Puerto Rico - Governor Authorized Representative (GAR):			
Homeland Security Grants Program	97.067	Not Available	48,858
<b>Total U.S. Department of Homeland Security</b>			<b>48,858</b>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<b>\$1,770,608</b>

The accompanying notes are an integral part of this schedule.

**1. BASIS OF PRESENTATION:**

Expenditures reported on the Schedule are reported on the modified-accrual basis of accounting, except for Section 8 Housing Choice Voucher Program (HCV). Expenditures are recognized when the related liability is incurred following the cost principles contained in OMB Circular A-87 Cost Principles for State, Local and Indian Tribal Governments, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Expenditures for HCV Program are reported on a statutory basis as required by the U.S. Department of Housing and Urban Development. Such expenditures should equal the net ACC subsidy for the PHA's fiscal period.

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

State or local government redistributions of federal awards to the Municipality, known as "pass-through awards", should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for the federal awards received as a sub recipient.

**2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:**

Expenditures of the federal awards as reported in the Statements of Revenues, Expenditures and Changes in Fund Balances – Governmental funds, are included within the Other Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

<u>Description</u>	<u>Other Governmental Funds</u>
Per Schedule of Expenditures of Federal Awards	\$ 1,770,608
Additional amount recorded as expenditures under modified accrual basis for Section 8 HCV Program	32,551
Non-federal awards expenditures	<u>1,375,618</u>
<b>Total expenditures in the basic financial statements</b>	<b><u>\$ 3,178,777</u></b>



*López-Vega, CPA, PSC*

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

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

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Arroyo, Puerto Rico, (Municipality)** as of and for the year ended June 30, 2014, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated March 10, 2015. 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 **2014-003**, to be material weaknesses.

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

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 **2014-001**, **2014-002**, **2014-003** and **2014-004**, 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 10, 2015

Stamp No. 2705433 of the Puerto Rico  
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was affixed to the record copy of this report.



*López-Vega, CPA, PSC*  
Certified Public Accountants / Management Advisors

## INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR 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, 2014. 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, 2014. 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 **2014-005** through **2014-010**.

### 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.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR 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 questions costs as items **2014-005** thru **2014-010**. 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 10, 2015.

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 10, 2015

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

**Financial Statements**

Type of auditor's report issued:	<b>Unmodified 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:	<b>Unmodified</b>	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes X	No

Identification of major programs:

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

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

Section II – Financial Statements Findings

**Finding Reference** 2014-001

**Requirement** Operating deficit of general fund

**Statement of Condition** As of June 30, 2014, the Municipality closed with an accumulated deficit in its General Fund of \$1,330,137. The current year operation closed with a net change in fund balances in the General Fund amounting to (\$547,541). The Municipality does not provide sufficient resources in the budget of the fiscal year 2013-2014 to amortize the accumulated deficit.

**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 if it 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 for several years.

**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

**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.

Section II – Financial Statements Findings

Finding Reference      2014-001 (Continued)

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 2015-2016. Also, during fiscal year 2014-2015, the Finance Director should monitor the actual revenues and expenditures in order to eliminate the accumulated deficit.

Implementation Date:      June, 2015

Responsible Person:      Eugenia Devarie  
Finance Department Director

**Section II – Financial Statements Findings**

<b>Finding Reference</b>	<b>2014-002</b>
<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

Section II – Financial Statements Findings

Finding Reference      2014- 002 (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:      June 2015

Responsible Person:      Eugenia Devarie  
Finance Department Director

Section II – Financial Statements Findings

<b>Finding Reference</b>	<b>2014-003</b>
<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, 2014, 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, 2014.</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.

Section II – Financial Statements Findings

Finding Reference      2014-003 (Continued)

**Management Response**      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 ensuned that this method complied with GAAP. 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 2015

Responsible Person:      Eugenia Devarie  
Finance Department Director

Section II – Financial Statements Findings

<b>Finding Reference</b>	<b>2014-004</b>
<b>Requirement</b>	<b>Expenditures for Goods and Services and Accounts Payables- Purchasing and receiving</b>
<b>Statement of Condition</b>	<p>We performed a cash disbursements test and examined thirty nine (39) payments which belonged to General Fund, thirteen (13) which belonged to Capital Project Funds, three (3) which belonged to Joint Resolution and five (5) which belonged to Community Development Block Grants – State's Program (CDBG). The following will summarize the internal control exceptions noted:</p> <ul style="list-style-type: none"><li>a. In one (1) payments which belonged to General Fund, one (1) which belonged to Capital Project Fund and two (2) payment which belonged to to Joint Resolution, the Purchase Order was not issued before the receiving of good or services.</li><li>b. In two (2) payments which belonged to General Fund, one (1) which belonged to Capital Project Fund, the disbursement vouchers did not include the invoice.</li><li>c. In seven (7) payments which belonged to General Fund, two (2) which belonged to Capital Project Fund the disbursement vouchers did not include at least three quotations for the purchase.</li><li>d. In eight (8) payments which belonged to General Fund, in Capital Project Fund, the disbursement vouchers did not include pre-intervention signatures.</li></ul>
<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 ensure 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 ensure that the disbursement vouchers contain all the necessary supporting documents before making the payments and are available for examination.

**Section II – Financial Statements Findings**

**Finding Reference**      **2014-004 (Continued)**

**Questioned Costs**      None

**Management Response  
and Corrective Action**

We are improving our internal controls in order to ensure that all required information is obtained before making a disbursement.

Implementation Date:      June 2015

Responsible Person:      Eugenia Devarie  
Finance Department Director

Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	2014-005
<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 2015  Responsible Person: Juan Devarie Section 8 Program Coordinator

Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	<b>2014-006</b>
<b>Program</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 – Utility Allowance Schedule</b>
<b>Statement of Condition</b>	The PHA did not maintain an up-to-date utility allowance schedule for the audit period ending June 30, 2014. The PHA did not perform a review of the utility rates during the fiscal year to ascertain if there has been a change of ten (10) percent or more in the utility rate.
<b>Criteria</b>	Code of Federal Regulations 24, Subpart K, Section 982.517 states that the PHA must maintain an up-to-date utility allowance schedule. The PHA must review utility rate data for each utility category on a yearly basis and must adjust its allowance schedule if there has been a rate change of ten percent or more for a utility category or fuel type since the last time utility allowance was revised.
<b>Cause of Condition</b>	The PHA did not follow the procedures established to review utility rate date each year.
<b>Effect of Condition</b>	The PHA is not in compliance with the Code of Federal Regulations 24, Subpart K, and Section 982.517.
<b>Recommendation</b>	The PHA should evaluate utility allowance rate each year as established in the federal regulations.
<b>Questioned Costs</b>	None.
<b>Management Response and Corrective Action</b>	To correct the condition reported by the external auditors, we will review the utility rate data for each category in order to determine any adjustment necessary to the utility allowance in use.
	Implementation Date: July 2015
	Responsible Person: Juan Devarie Section 8 Program Coordinator

Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	2014-007
<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 – Housing Quality Standards Inspections and HQS Enforcement
<b>Statement of Condition</b>	<p>During our audit, we noted that the Municipality did not comply with the compliance requirement of Housing Quality Control re-inspections during the fiscal year 2013-2014. The following will summarize the exception noted:</p> <p>a. We noted that during the fiscal year after our review, the quality control re-inspections were conducted three (3) to fifty eight (58), more than ninety (90) days after the original inspection.</p>
<b>Criteria</b>	Code of Federal Regulations 24, Subpart I, 982.404 and Section 982.158 (d) and 982.405 (b) states that the PHA must inspect the unit leased to a family at least annually to determine if the unit meets Housing Quality Standards (HQS) and the PHA must conduct quality control re-inspections. Also the PHA must prepare a unit inspection report.
<b>Cause of Condition</b>	The Municipality did not maintain adequate monitoring procedures to ensure that annual re-inspections Housing Quality Control re-inspections are properly performed.
<b>Effect of Condition</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Section 982.404 and 982.158 (d) and 982.405 (b).
<b>Recommendation</b>	We recommend management to implement internal control procedures to ensure that annual inspections and quality control re-inspections are properly performed. The PHA supervisor or other qualified person must re-inspect a sample of units under contract during the last PHA fiscal year. Completed HQS inspections included in the sample must be no older than three months at the time of re-inspection. In addition, the quality control re-inspection should provide feedback on inspector's work, which can be used to determine if individual performance or general HQS training issues need to be addressed.
<b>Questioned Costs</b>	None

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference      2014-007 (Continued)

**Management Response  
and Corrective Action**

The Director will evaluate the established internal procedures related to the re-inspection's files to improve such procedures and to ensure that mentioned situations are not repeated. The Director, also, will assign to an employee to evaluate the re-inspection files and verify the compliance with the required documents.

Implementation Date:      July 2015

Responsible Person:      Juan Devarie  
Section 8 Program Coordinator

Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	<b>2014-008</b>
<b>Program</b>	<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>
<b>Requirement</b>	<b>Allowable Activities-Housekeepers Activity</b>
<b>Statement of Condition</b>	<p>We performed a housekeeper activity test of fifteen (15) participant’s files and found the following exceptions:</p> <ul style="list-style-type: none"><li>a) In four (4) participant’s files, we noted that the service contract (Form OCAM-AH-005) that established the service plan to be offered by the CDBG Program between the Municipality and the participant was not available for our examination.</li><li>b) In the fifteen (15) participant’s files, although we did not find evidence that visits were performed during the contract period, the program staff did not visited at least twice per month the participant’s housing unit to ensure the quality of services, according to the activity procedures guide.</li><li>c) In the seven (7) participant’s files, we noted that the contracts formalized by the Program did not establish the services to be offered. Also, the eligibility approval forms were not completed by the program staff.</li><li>d) In five (5) 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.</li><li>e) In one (1) participant’s files was not available for our examination.</li></ul>
<b>Criteria</b>	Code of Federal Regulations 24, Section 570.484 states that the Municipality must ensure that the program funds benefit very low, low- and moderate income persons and retain documentation justifying its certification. Also, the Municipality has an operational guide that includes all procedures and program’s requirements for housekeeper activities.
<b>Cause of Condition</b>	The Municipality’s controls and procedures failed to ensure that the participant’s files include all the required documents to comply with the program requirements.
<b>Effect of Condition</b>	The Municipality is not in compliance with the Code of Federal Regulations 24, Section 570.484 and with the operational guide.
<b>Recommendation</b>	We recommended management to follow the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures manual, including the use of the forms included on it.

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

**Finding Reference**      2014-008 (Continued)

**Questioned Costs**      None

**Management Response  
and Corrective Action**

The Program staff with the responsibilities to maintain the participants' files in compliance with the Program regulations was required to take corrective measures in order to ensure application of all of the procedures according to the guide "Guía Operacional para la Prestación del Servicio de Auxiliares en el Hogar". Regarding the required visits, a revised Guide has been submitted to OCAM reducing the number of visits to one (1), which be applied prospectively. Also, the Program staff will be monitored frequently for compliance, by the Federal Programs Department Director.

Implementation Date:      June 2015

Responsible Person:      Héctor Caraballo  
Federal Programs Department Director

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

<b>Finding Reference</b>	<b>2014-009</b>
<b>Program</b>	<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>
<b>Requirement</b>	<b>Davis-Bacon Act</b>
<b>Statement of Condition</b>	<p>During our Davis-Bacon Act test, we verified (1) construction project file with a cost of \$74,999.63. The following will summarize the exceptions noted:</p> <p>a) We noted that during the fiscal year 2013-2014, the construction project file was not available for our examination.</p>
<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>	We recommend that the Municipality should maintain supporting evidence for all construction projects.
<b>Questioned Costs</b>	None
<b>Management Response and Corrective Action</b>	<p>All files have been revised in order to ensure compliance with applicable federal statues. The Director has been instructed to establish an internal work to examine internal policies and procedures regarding to Davis Bacon. All file will be revised to include all information required in accordance with Federal Regulations.</p> <p>Implementation Date: June 2015</p> <p>Responsible Person: Héctor Caraballo Federal Programs Department Director</p>

Section III – Major Federal Award Program Findings and Questioned Costs

<b>Finding Reference</b>	<b>2014-010</b>
<b>Program</b>	<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>
<b>Requirement</b>	<b>Program Income</b>
<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 ensure 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 ensure 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).
<b>Recommendation</b>	We recommend management to develop internal controls and procedures in order to ensure that the handling of Program Income complies with federal and state requirements.

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

**Finding Reference**      **2014-010 (Continued)**

**Questioned Costs**      None

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

Implementation Date:      June 2015

Responsible Person:      Héctor Caraballo  
Federal Program Department Director

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
13-05	14.871	<p><u>Of a sample of ten (10) disbursements examined, two (2) disbursement orders did not have the signature of the Pre-intervention Officer.</u></p> <p>Corrective action has been taken.</p>
13-06	14.871	<p><u>Two (2) disbursements made for purchases under \$10,000, from a sample of ten (10) disbursements examined, did not include as part of the supporting documents written quotations as evidence of price solicitation to suppliers.</u></p> <p>Corrective action has been taken.</p>
13-07	14.871	<p><u>Of a sample of ten (10) disbursements examined of Housing Choice Vouchers program and ten (10) disbursements examined of Section 8 Moderate Rehabilitation program. a) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a purchase under \$10,000, does not include a written certification stating that merchandise was received and agrees in quantities and specifications to the purchase order, and. b)Six (6) disbursements belonging to the Housing Choice Vouchers program and eight (8) disbursements belonging to the Moderate Rehabilitation program, made for HAP payments, did not have a list or schedule supporting the amount paid. c) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a transaction over \$10,000, did not have a list or schedule supporting the amount paid and. d) One (1) disbursement belonging to the Moderate Rehabilitation program, made for a transaction over \$10,000, the disbursement order and its supporting documents was not available.</u></p> <p>Corrective action has been taken.</p>
13-08	14.228	<p><u>We requested two (2) contractor's payroll in order to verify the wage rates paid by the contractor and if laborers and mechanics were paid full amounts accrued at time of payment, computed at wage rates not less t those stated in the advertised specifications. For one contract the Federal Awards Department of the Municipality did not perform the procedure</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference <b>2014-009</b>.</p>

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
13-05	14.871	<p><u>Of a sample of ten (10) disbursements examined, two (2) disbursement orders did not have the signature of the Pre-intervention Officer.</u></p> <p>Corrective action has been taken.</p>
13-06	14.871	<p><u>Two (2) disbursements made for purchases under \$10,000, from a sample of ten (10) disbursements examined, did not include as part of the supporting documents written quotations as evidence of price solicitation to suppliers.</u></p> <p>Corrective action has been taken.</p>
13-07	14.871	<p><u>Of a sample of ten (10) disbursements examined of Housing Choice Vouchers program and ten (10) disbursements examined of Section 8 Moderate Rehabilitation program. a) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a purchase under \$10,000, does not include a written certification stating that merchandise was received and agrees in quantities and specifications to the purchase order, and. b) Six (6) disbursements belonging to the Housing Choice Vouchers program and eight (8) disbursements belonging to the Moderate Rehabilitation program, made for HAP payments, did not have a list or schedule supporting the amount paid. c) One (1) disbursement belonging to the Housing Choice Vouchers program, made for a transaction over \$10,000, did not have a list or schedule supporting the amount paid and. d) One (1) disbursement belonging to the Moderate Rehabilitation program, made for a transaction over \$10,000, the disbursement order and its supporting documents was not available.</u></p> <p>Corrective action has been taken.</p>
13-08	14.228	<p><u>We requested two (2) contractor's payroll in order to verify the wage rates paid by the contractor and if laborers and mechanics were paid full amounts accrued at time of payment, computed at wage rates not less than those stated in the advertised specifications. For one contract the Federal Awards Department of the Municipality did not perform the procedure</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference <b>2014-009</b>.</p>

13-09	14.856	<p><u>Of a sample of nine (9) tenants files selected for our test, we found the following:</u>  <u>a)Tenant file was not available, 1 instance, representing 11% of sample.</u></p> <p>Corrective action has been taken.</p>
13-10	14.856	<p><u>Of a sample of nine (9) tenants files selected for our test, we found the following. a)</u>  <u>Tenant income for Temporary Assistance for Needy Families was not accurately recorded in form HUD-50058, 1 instance, representing 11% of sample,</u></p> <p>Corrective action has been taken.</p>
13-11	14.871	<p><u>The Municipality did not have written policies in its Housing Choice Voucher Program (HCVP) administrative plan for selecting applicants from the waiting list.</u></p> <p>Corrective action has been taken.</p>
13-12	14.228	<p><u>1-Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property, and 2)A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.</u></p> <p>Corrective action has been taken.</p>
13-14	14.856	<p><u>The Municipality did not provide a reserve for replacement account and could not provide evidence of the required monthly deposit to the account</u></p> <p>Corrective action has been taken.</p>

13-15	14.871	<p><u>The Municipality did not comply with the compliance requirement of Depository Agreements. The Public Housing Agencies (PHA) is required to enter into depository agreement with their financial institutions in the form required by HUD. (Form HUD-51999)</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference <b>2014-005</b>.</p>
12-05	14.856	<p><u>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.</u></p> <p>Corrective action has been taken.</p>
12-06	14.871	<p><u>In our Waiting List test, we noted the following situations: a) The PHA did not have written policies in its HCVP administrative plan for selecting applicants from the waiting list. b) The PHA has no evidence of the public notice to the families when it opened and closed the waiting list.</u></p> <p>Corrective action has been taken.</p>
12-07	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 has been taken. The auditors reissued the finding in the current year. See Finding Reference <b>2014-005</b>.</p>

12-08	14.228	<p><u>During our Davis-Bacon Act test, we verified one (1) construction project. The following will summarize the exceptions noted: 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. b) We did not obtain evidence that the Municipality's monitors certified the weekly payroll supplied by the contractors. c) The contractor did not submit the certifications and copies of payroll. (Weekly payroll)</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference <b>2014-009</b>.</p>
12-09	14.228	<p><u>During our audit of the program income requirements we noted that the Municipality did not maintain internal controls to ensure the proper determination, accounting and use of program income, as discuss below: a) Program income records were not available for our examination. a) Program income was not reported in accordance with the program requirements and other regulations applicable.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference <b>2014-010</b>.</p>
12-10	93.575	<p><u>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.</u></p> <p>Corrective action has been taken.</p>
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>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal Audit Clearinghouse.</p>

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

