

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

**MUNICIPIO DE BARRANQUITAS  
AUDITORÍA 2009-2010  
30 DE JUNIO DE 2010**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS**

**SINGLE AUDIT REPORT  
Fiscal Year Ended  
June 30, 2010**

**BASIC FINANCIAL STATEMENTS AND  
SUPPLEMENTAL SCHEDULE**

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With Independent Auditors' Report Thereon  
June 30, 2010

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**Commonwealth of Puerto Rico**  
**Municipality of Barranquitas**  
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Fiscal Year ended June 30, 2010

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**Independent Auditors' Report on Basic Financial Statements and Supplementary Schedule of Expenditures of Federal Awards**

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Barranquitas of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2010, which collectively comprise the Municipality's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Barranquitas of the Commonwealth of Puerto Rico, as of June 30, 2010, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards we have also issued our report dated December 9, 2010, on our consideration of the Municipality of Barranquitas of the Commonwealth of Puerto Rico internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The accompanying Management's Discussion and Analysis and the Budgetary Comparison Schedule are not required parts of the basic financial statements referred to above, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of

federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States and Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of the Municipality. The Schedule of Expenditures and Federal Awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

December 9, 2010  
Toa Alta, Puerto Rico

Stamp No. 2448903  
was affixed to the  
original report.



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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2010

As management of the Municipality of Barranquitas (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2010. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the Municipality's financial statements, which follow this narrative.

**FINANCIAL HIGHLIGHTS**

***Government-Wide Highlights:***

- The Municipality's assets exceeded its liabilities (net assets) by \$21,381,355 at June 30, 2010. The Municipality's net assets increased by \$958,635 during the fiscal year ended June 30, 2010.
- The Municipality's assets increased from \$42,613,077 at June 30, 2009 to \$45,304,019 at June 30, 2010, for an increase of \$2,690,942.
- The liabilities of the Municipality increased from \$22,190,357 at June 30, 2009 to \$23,922,664 at June 30, 2010, for an increase of \$1,732,307.
- The revenues of the Municipality increased from \$12,201,601 for the fiscal year ended June 30, 2009 to \$14,404,544 for the fiscal year ended June 30, 2010, for an increase of \$2,202,943.
- The Municipality's expenses increased from \$12,341,060 for the fiscal year ended June 30, 2009 to \$13,445,909 for the fiscal year ended June 30, 2010, for an increase of \$1,104,849.

***Governmental Funds' Highlights:***

- The total fund balances of governmental funds amounted to \$9,458,292 at June 30, 2010, which increased by \$309,117 during fiscal year ended June 30, 2010.
- The total assets of governmental funds increased from \$16,757,229 at June 30, 2009 to \$18,485,385 at June 30, 2010, for an increase of \$1,728,156.
- The governmental fund's total liabilities increased from \$7,608,054 at June 30, 2009 to \$9,027,093 at June 30, 2010, for an increase of \$1,419,039.
- The total revenues of governmental funds increased from \$13,580,829 for the fiscal year ended June 30, 2009 to \$14,415,691 for the fiscal year ended June 30, 2010, for an increase of \$834,862.
- The governmental fund's total expenditures increased from \$13,828,058 for the fiscal year ended June 30, 2009 to \$14,106,574 for the fiscal year ended June 30, 2010, for an increase of \$278,516.

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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2010

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2010. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

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

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

**a) *Government-wide Financial Statements***

The GWFS are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2010. The GWFS are prepared using methods that are similar to those used by most private businesses.

**1. *Statement of Net Assets***

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality.

On the other hand, the Municipality reports liabilities, such as claims and judgments, even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets and total liabilities reported in SNA is presented as *net assets*, which is similar to the total owners' equity reported by a commercial

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enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net assets, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

**2. Statement of Activities**

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2010, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

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

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

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

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

**b) Governmental Fund Financial Statements**

The Municipality's GFFS consist of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds, and (3) the statement of revenues and expenditures-budget and actual-budgetary basis-general fund. These financial statements report the financial position and results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major governmental funds.

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

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requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

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

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

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

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

The Municipality has five (5) major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The five (5) major governmental funds are: (1) general fund, (2) capital improvements bond fund, (3) legislative joint resolutions fund, (4) debt service fund, and (5) community development block grant fund.

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**c) *Notes to Basic Financial Statements***

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

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**d) Other Supplementary Information**

The basic financial statements are followed by a section of other supplementary information consisting of: (1) combining balance sheet – non-major governmental funds, (2) combining statement of revenues, expenditures and changes in fund balances – non-major governmental funds, (3) budgetary comparison schedule – debt service fund, (4) notes to budgetary comparison schedule – debt service fund, and (5) schedule of capital assets used in the operation of governmental funds, as detailed in the accompanying table of contents.

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The Municipality's overall financial position, for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

**Comparative Statement of Net Assets**  
**Governmental Activities (Condensed)**  
**June 30, 2010 and 2009**

<b>Assets:</b>	<u><b>2010</b></u>	<u><b>2009</b></u>
Current assets	\$ 18,126,776	\$ 16,342,208
Non-current assets:		
Capital assets, net	27,152,678	26,244,811
Other non-current assets	24,565	26,058
Total assets	<u>45,304,019</u>	<u>42,613,077</u>
 <b>Liabilities:</b>		
Current liabilities	8,412,539	7,317,051
Long-term obligations due within one year	1,037,898	612,899
Long-term obligations due after one year	14,472,227	14,260,407
Total liabilities	<u>23,922,664</u>	<u>22,190,357</u>
 <b>Net assets:</b>		
Invested in capital assets, net of related debt	24,843,751	23,442,377
Restricted for debt service and others	2,120,804	2,041,067
Unrestricted	(5,583,200)	(5,060,724)
Total net assets	<u>\$ 21,381,355</u>	<u>\$ 20,422,720</u>

At June 30, 2010, the Municipality's current assets, amounting to \$18,126,776, are mainly composed of cash in banks (\$15,281,403) of which \$11,979,941 are restricted, property taxes receivable of \$1,150,527 net of allowance for doubtful accounts, municipal license taxes receivable of \$5,970, net of allowance for doubtful accounts, and intergovernmental receivables of \$1,575,835, net of allowance for doubtful accounts.

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The restricted cash of \$11,979,941 represents resources legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant award programs. A portion of property taxes receivable, amounting to \$5,821, net of allowance for doubtful accounts, represents restricted resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's non-current assets, amounting to \$27,177,243 at June 30, 2010, are substantially composed of capital assets, with an aggregate cost basis of \$43,655,957, which are reported net of accumulated depreciation and amortization of \$16,503,279.

During the fiscal year ended June 30, 2010, the assets of the Municipality increased by \$2,690,942 in comparison with the prior fiscal year, principally for the net effect of the following facts:

- Cash in banks increased by \$1,511,879 mainly due to an increase in the collections of property taxes during the fiscal year ended June 30, 2010.
- Capital assets increased by \$907,867 due to the excess of current year additions (\$2,015,966) over depreciation/amortization expense (\$1,108,099) for the fiscal year ended June 30, 2010. The principal additions to capital assets for the current fiscal year were related to construction in progress (\$1,580,436), building, structures and building improvements (\$290,578), infrastructure land (\$115,332), and machinery, equipment, furniture and fixtures (\$29,620).

At June 30, 2010, the Municipality's current liabilities amounting to \$9,450,437 are mainly composed of unearned revenues (\$6,093,597), accounts payable and accrued liabilities (\$2,318,942) and the portions due within one year of compensated absences (\$609,973) and bonds payable (\$425,000). Deferred revenues consist of unearned revenues associated with municipal license taxes (\$542,060) and intergovernmental grants and contributions related to state and federally funded programs (\$5,551,537). As noted in the condensed statement of net assets, the Municipality's current assets exceeded current liabilities by \$8,676,339, for a current ratio (current assets to current liabilities) of 1.92 to 1.00.

The Municipality's non-current liabilities, amounting to \$14,472,227 at June 30, 2010, are composed of portions due after one year of bonds payable (\$5,755,000), compensated absences (\$945,767), and the estimated liability for municipal solid waste landfill closure and post-closure care costs (\$7,771,460).

At June 30, 2010, the liabilities of the Municipality increased by \$1,732,307 in comparison with the prior fiscal year, principally for the following facts:

- Unearned revenues increased by \$901,727, which was caused principally by the increase in unearned grants and contributions of federal and state funded grant award programs.
- Accounts payables to suppliers and accrued liabilities increased by \$551,011 during fiscal year.
- Bonds payable decreased by \$425,000 due to the effect of the debt service principal payments during the current fiscal year.

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial statement position. The assets of the Municipality exceeded liabilities by \$21,381,355 at June 30, 2010. The most significant portion of net assets (\$24,843,751) reflects the Municipality's investment in capital

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Fiscal Year Ended June 30, 2010

assets (e.g. land, buildings, machinery, equipment, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses the capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, as capital assets cannot be used to liquidate these liabilities.

Another significant portion of net assets at June 30, 2010, represents resources that are restricted for debt service payments (\$1,714,839) and the operations of state and federally funded grant award programs (\$405,965). The remaining component of total net assets consists of unrestricted negative balance of (\$5,583,200) at June 30, 2010. This unrestricted negative balance is the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds payable, notes payable compensated absences, claims and judgments, obligations under capital leases, estimated liability for municipal solid waste landfill closure and post-closure care costs, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality increased by \$958,635 for the fiscal year ended June 30, 2010. Such increase is due to the excess of total revenues (\$14,404,544) over expenses (\$13,445,909) for the fiscal year ended June 30, 2010.

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2010

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

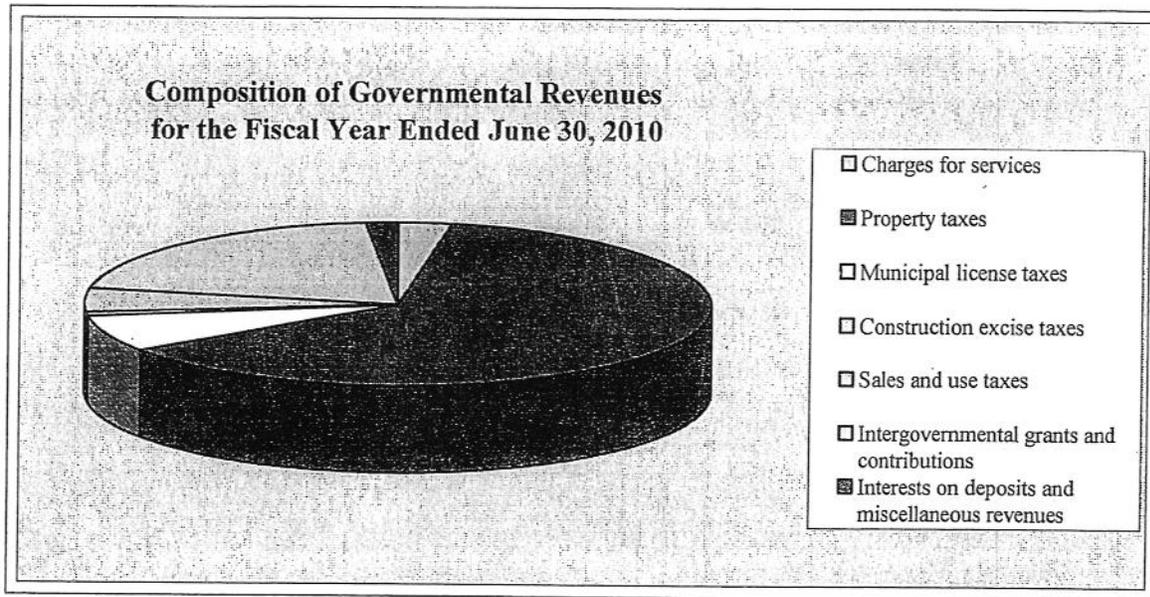
**Comparative Statement of Activities**  
**Governmental Activities (condensed)**  
Fiscal Years Ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Program revenues:</b>		
Program-specific operating grants and contributions	\$ 1,346,354	\$ 1,255,797
Program-specific capital grants and contributions	1,616,281	1,639,929
Charges for services	332,661	184,974
Total program revenues	<u>3,295,296</u>	<u>3,080,700</u>
<b>General revenues:</b>		
Property taxes	7,124,088	6,341,420
Municipal license taxes	840,101	930,600
Construction excise taxes	95,809	80,715
Sales and use tax	553,210	813,472
Unrestricted grants and contributions	2,311,272	504,352
Interests on deposits and miscellaneous revenues	184,768	450,342
Total general revenues	<u>11,109,248</u>	<u>9,120,901</u>
Total revenues	<u>14,404,544</u>	<u>12,201,601</u>
<b>Program expenses:</b>		
General government	5,345,287	4,169,762
Urban and economic development	2,104,213	1,682,106
Public safety	1,076,221	1,101,986
Health and sanitation	2,031,413	2,131,370
Culture, recreation and education	806,191	713,923
Public housing and welfare	1,867,859	2,227,887
Interest on long-term obligations	214,725	314,026
Total expenses	<u>13,445,909</u>	<u>12,341,060</u>
<b>Net increase (decrease) in net assets</b>	<u>958,635</u>	<u>(139,459)</u>
<b>Net assets, at beginning of fiscal year</b>	<u>20,422,720</u>	<u>20,562,179</u>
<b>Net assets, at end of fiscal year</b>	<u>\$ 21,381,355</u>	<u>\$ 20,422,720</u>

As previously mentioned, the Municipality's net assets increased by \$958,635 during the current fiscal year. Approximately 60 percent (\$8,613,208) of the Municipality's total revenues for the current fiscal year came from taxes (property taxes, municipal license taxes, construction excise taxes and sales and use taxes), while 23 percent (\$3,295,296) resulted from program revenues.

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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2010

The following chart presents the composition of revenues for the fiscal year ended June 30, 2010:



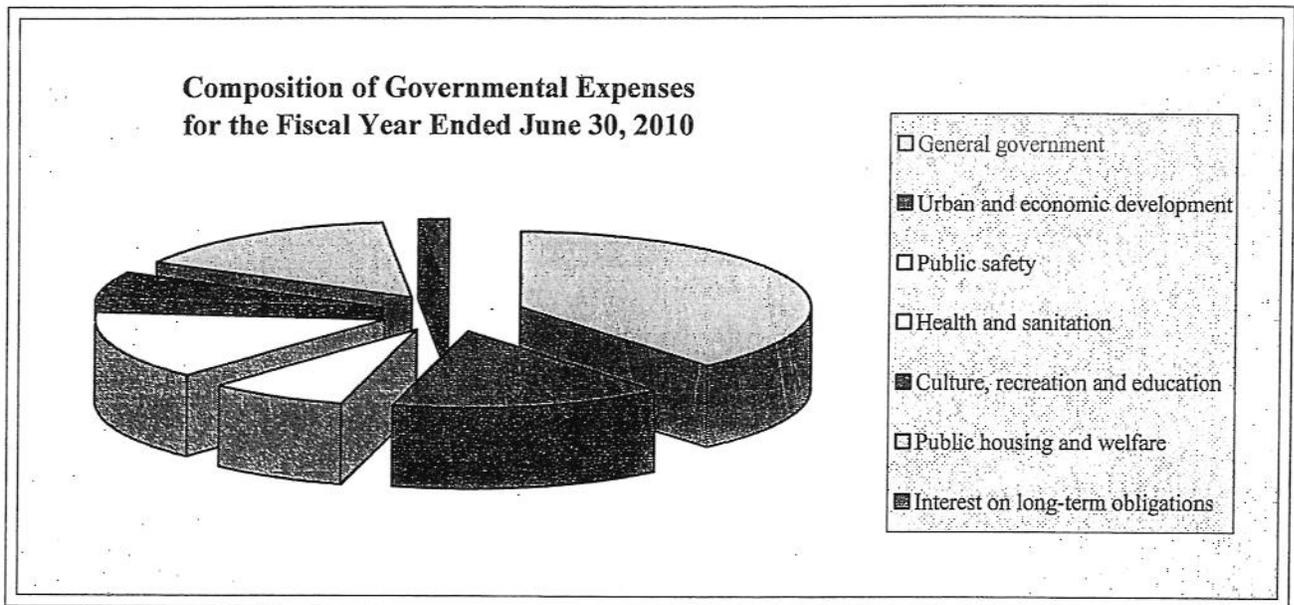
The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2010 were related to: (1) general administrating and operating costs (\$5,345,287), which were classified as "general government", (2) public housing and welfare), (\$1,867,859), (3) urban and economic development (\$2,104,213), and (4) health and sanitation (\$2,031,413).

As previously mentioned, the Municipality's expenses increased from \$12,341,060 for the fiscal year ended June 30, 2009 to \$13,445,909 for the fiscal year ended June 30, 2010, for an increase of \$1,104,849. The most significant fluctuation between the current fiscal year's expenses and those of the prior fiscal year occurred in the general government expenses, which increased \$1,175,525 and payment of interest on long term obligation, which decreased \$99,301 during current fiscal year.

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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2010

The following chart presents the composition of expenses for the fiscal year ended June 30, 2010:



**Condensed Balance Sheet - Governmental Funds  
June 30, 2010 and 2009**

	2010	2009
<b>Assets:</b>		
Total assets - major governmental funds	\$ 16,448,534	\$ 14,898,574
Total assets - other governmental funds	2,036,851	1,858,655
Combined total assets	<u>18,485,385</u>	<u>16,757,229</u>
<b>Liabilities:</b>		
Total liabilities - major governmental funds	7,406,287	6,115,617
Total liabilities - other governmental funds	1,620,806	1,492,437
Combined total liabilities	<u>9,027,093</u>	<u>7,608,054</u>
<b>Fund balances:</b>		
Reserved - major governmental funds	5,267,567	5,650,594
Reserved - other governmental funds	416,045	366,218
Unreserved - general fund	3,774,680	3,132,363
Combined total fund balances	<u>9,458,292</u>	<u>9,149,175</u>
<b>Total liabilities and fund balances</b>	<u>\$ 18,485,385</u>	<u>\$ 16,757,229</u>

COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2010

**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

*Analysis of Financial Position of Governmental Funds*

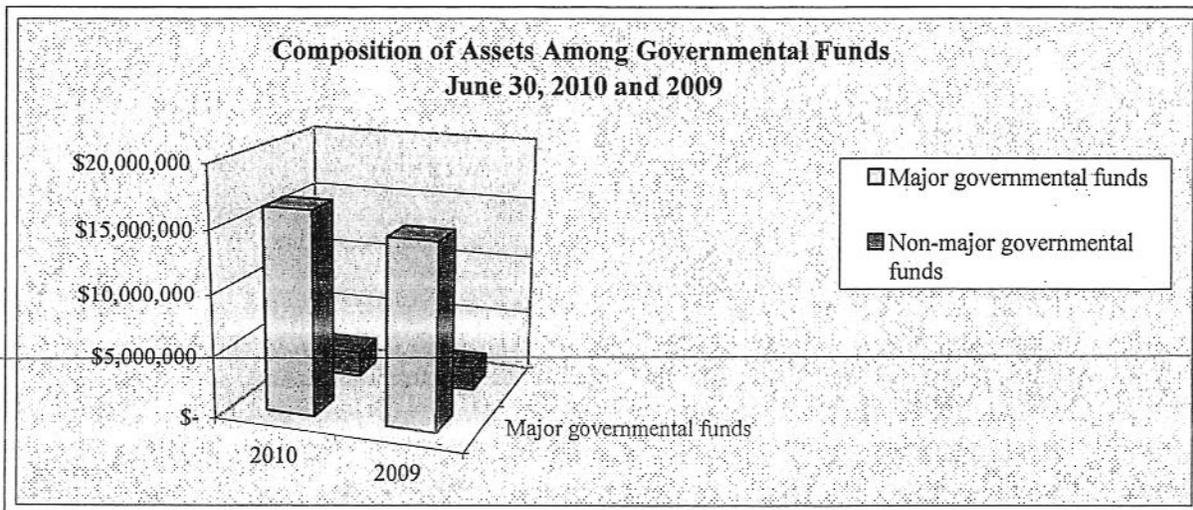
As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information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

At June 30, 2010, the total assets of governmental funds increased of \$1,728,158 in comparison with the prior fiscal year principally for the net effect of the following facts:

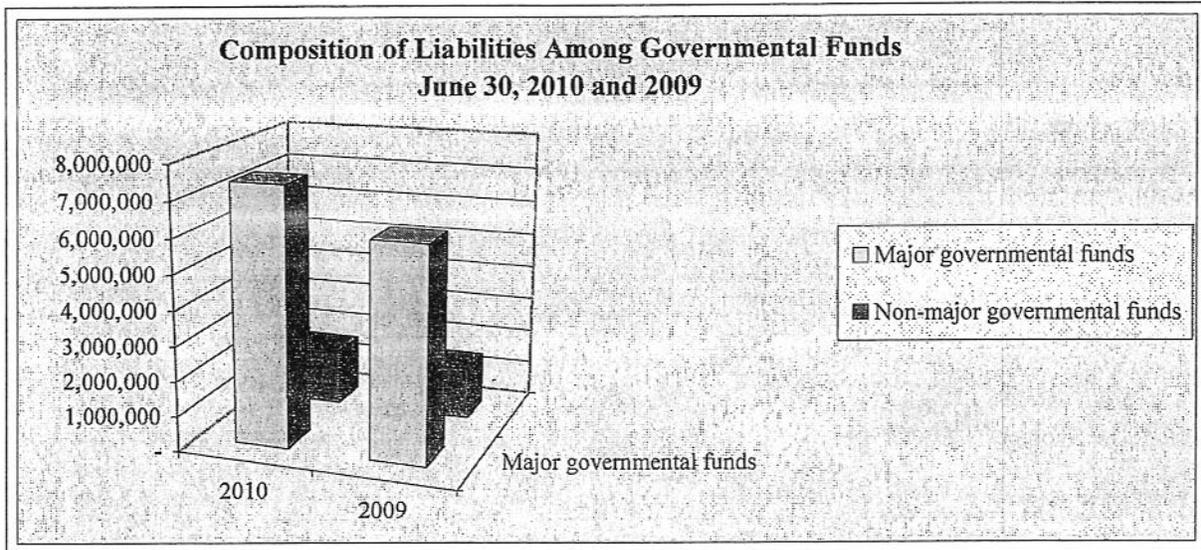
- Cash in banks increased by \$1,511,879 mainly due to an increase in property taxes collections during the fiscal year ended June 30, 2010.
- Property taxes receivable increased by \$23,768, principally by the decrease of \$584,858 in property tax revenues during the current fiscal year, partially offset by increased collections during the current fiscal year.

For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made.

At the end of the current fiscal year, total unreserved fund balances of governmental funds amounted to \$3,774,680 (recorded in general fund), while total fund balance reached \$9,458,292. The total fund balances increased by \$309,117 during the current fiscal year. The following tables present the composition of assets, liabilities and fund balances among governmental funds at June 30, 2010 and 2009:

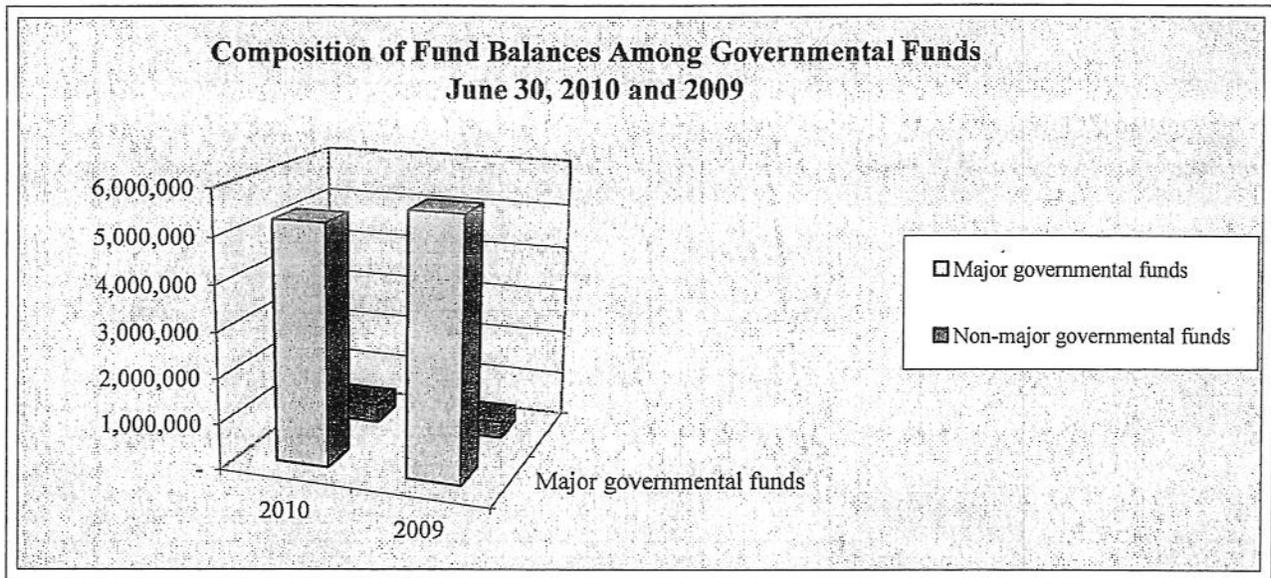


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The following is a detailed financial analysis of the Municipality's governmental funds:

**General fund (GF)** - The GF is the main operating fund used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund due to legal requirements, GAAP requirements or the demands of sound financial administration requiring the use of a governmental fund other than the general fund. The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$6,330,417 at June 30, 2010. Such assets consist principally of: (1) tax receivables (\$1,203,477), net of allowance for doubtful accounts, (2) unrestricted and restricted cash (\$3,590,305), and (3) short-term and long-term amounts due from other funds (\$408,802).

The GF's total liabilities amounted to \$2,321,258 at June 30, 2010. Such liabilities are composed of: (1) deferred revenues (\$604,008), and (2) accounts payable and accrued liabilities, including amounts due to other governments (\$1,717,250).

At the end of the current fiscal year, unreserved fund balance of the GF's amounted to \$3,774,680, while total fund balance reached \$4,009,159. As a measure of the GF's liquidity it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 34 percent of the total GF's expenditures, while total fund balance represents 36 percent of that same amount.

**Capital improvements bond fund (CIBF)** - The CIBF is a major capital projects fund used to account for the financial resources arising from bond issuance proceeds used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The CIBF's total assets amounted to \$3,425,523 at June 30, 2010, which consists mainly of restricted cash (unspent bond proceeds) in fiscal agent (\$3,421,508). The CIBF's total liabilities amounted to \$107,274 at June 30, 2010, which are mainly composed of: (1) amounts due to other funds (\$63,546) and (2) accounts payable and accrued liabilities (\$43,728). At the end of the current fiscal year, CIBF's total and reserved fund balance reached \$3,318,249.

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**Legislative joint resolutions fund (LJRF)** - The LJRF is a major capital project fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico, which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The LJRF's total assets amounted to \$4,231,233 at June 30, 2010, which consists of restricted cash (unspent grant awards and contributions) from the Legislature of the Commonwealth of Puerto Rico amounting to \$4,231,233. The LJRF's total liabilities amounted to \$4,231,233 at June 30, 2010, which are composed principally of deferred grant revenues of \$4,153,554.

**Debt service fund (DSF)** - The DSF is a major fund used to account for the accumulation of resources for, and the payment of, principal and interest for bonds payable. The DSF's total assets amounted to \$2,049,418 at June 30, 2010, which consists mainly of restricted cash in fiscal agent (\$2,007,922) and intergovernmental grants and contributions (\$35,530), net of allowance for doubtful accounts. The DSF's total liabilities amounted to \$334,579 at June 30, 2010, which are mainly composed of: (1) matured bonds due and payable (\$250,000) and (2) accounts payable and accrued liabilities (\$84,512). At the end of the current fiscal year, DSF's total and reserved fund balance reached \$1,714,839.

**Community development block grant fund (CDBGF)** - The CDBGF's is a major capital project fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the U.S. Department of Housing and Urban Development through the Puerto Rico Office of the Commissioner of Municipal Affairs (sub-grantor), which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The CDBGF's total assets amounted to \$411,943 at June 30, 2010, which consists principally grant awards receivable from the U.S. Department of Housing and Urban Development amounting to \$402,280. The CDBGF's total liabilities amounted to \$411,943 at June 30, 2010, which are composed of: (1) accounts payable and accrued liabilities (\$313,848) and (2) amounts due to other funds (\$98,095).

**Other governmental funds (OGF)** - The OGF's is a combination of non-major major capital project and special revenue funds principally used to account for the financial resources arising from program-specific capital and operating grants and contributions awarded by state and federal agencies. The OGF's total assets amounted to \$2,036,851 at June 30, 2010, which consist mainly of restricted cash (\$2,020,772). The OGF's total liabilities amounted to \$1,620,806 at June 30, 2010, which are mainly composed of deferred revenues (\$1,397,983) and short-term and long-term amounts due to other funds (\$182,688).

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**Changes in Fund Balances - Governmental Funds (condensed)**  
**Fiscal Years Ended June 30, 2010 and 2009**

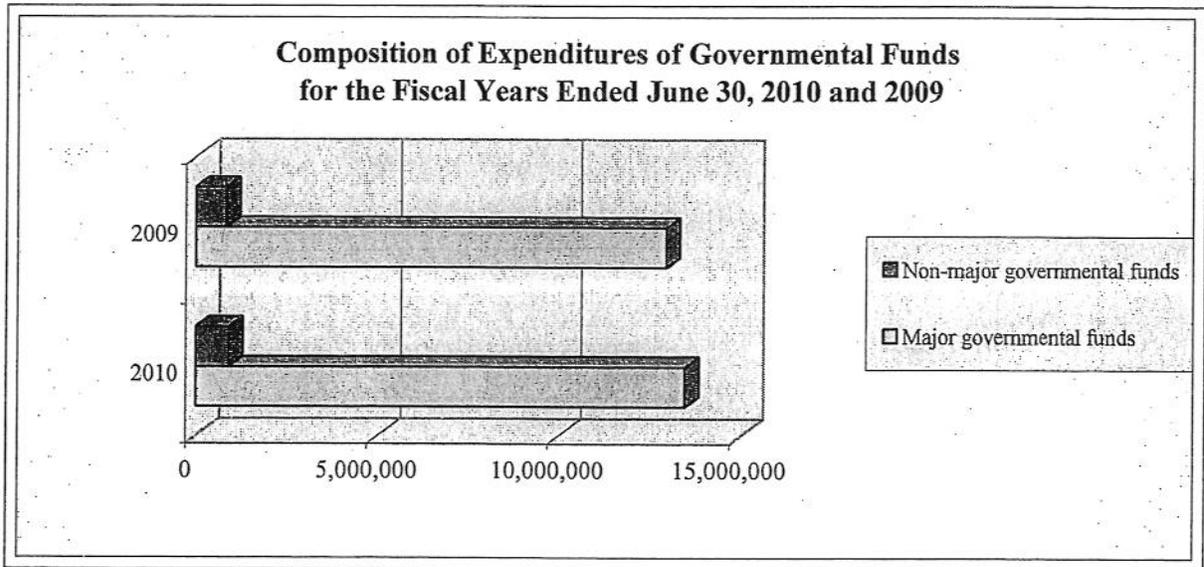
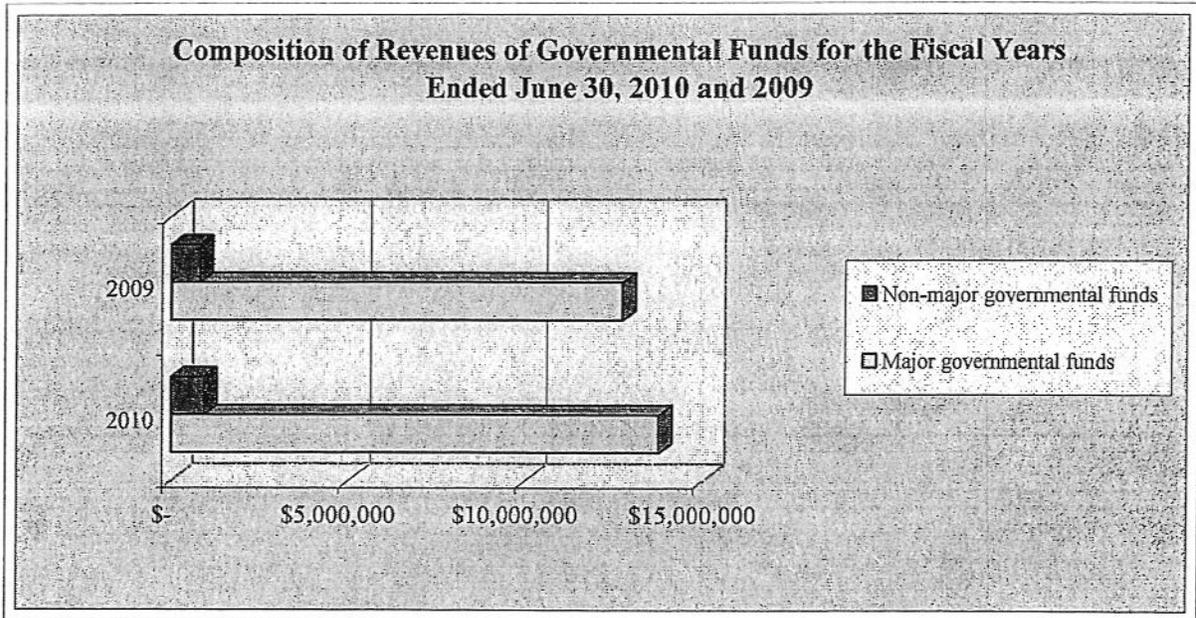
	<u>2010</u>	<u>2009</u>
<b>Revenues:</b>		
Total revenues - major governmental funds	\$ 13,480,750	\$ 12,763,805
Total revenues - other governmental funds	934,941	817,024
Combined total revenues	<u>14,415,691</u>	<u>13,580,829</u>
 <b>Expenditures:</b>		
Total expenditures - major governmental funds	13,196,938	12,989,838
Total expenditures - other governmental funds	909,636	838,220
Combined total expenditures	<u>14,106,574</u>	<u>13,828,058</u>
 <b>Excess (deficiency) of revenues over (under) expenditures</b>	<u>309,117</u>	<u>(247,229)</u>
 <b>Other financing sources (uses), net:</b>		
Other financing sources (uses), net - major governmental funds	(24,522)	(730,934)
Other financing sources (uses), net - other governmental funds	24,522	730,934
Combined other financing sources (uses), net	<u>-</u>	<u>-</u>
 <b>Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses</b>	309,117	(247,229)
 <b>Fund balances, at beginning of fiscal year</b>	<u>9,149,175</u>	<u>9,396,404</u>
<b>Fund balances, at end of fiscal year</b>	<u>\$ 9,458,292</u>	<u>\$ 9,149,175</u>

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**Analysis of Operating Results of Governmental Funds**



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The following is a detailed analysis of the results of operations of governmental funds for the fiscal year ended June 30, 2010:

**General fund** – The total fund balance of the GF increased \$78,234 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$11,107,593, \$11,050,332 and \$20,973, respectively, for the fiscal year ended June 30, 2010.

Approximately 75 percent (\$8,341,396) of the GF's total revenues for the current fiscal year came from taxes (property taxes, municipal license taxes, construction excise taxes and sales and use taxes, while 21 percent (\$2,311,272) resulted from intergovernmental grants and contributions.

During the current fiscal year, there was an excess of revenues and other financing sources over expenditures and other financing uses of \$78,234 in GF, while in the prior fiscal there was a deficiency of revenues and other financing sources under expenditures and other financing uses of \$317,285.

The GF's most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

- Total revenues increased \$778,923 (8%) in comparison with the prior fiscal year.
- Total tax revenues decreased \$986,309 (11%) in comparison with the prior fiscal year.
- Intergovernmental grants and contributions increased by \$1,806,365 (358%) in comparison with the prior fiscal year.
- Interest on deposits decreased \$52,825 during current fiscal year.
- Property taxes revenues decrease of \$650,642 is mainly due to an increase of \$23,768 in property taxes receivable while at the same time the current year property assessments and collections were greater than prior year.
- Miscellaneous income decreased \$51,327 during current fiscal year.

The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the general government expenditures, which increased by \$1,008,069 (25%).

**Capital improvements bond fund (CIBF)** – The most significant transactions of this fund for the current fiscal year are related to interest on deposits. The total fund balance of the CIBF did not have any net fluctuation during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$48,363, \$0 and \$48,363, respectively, for the fiscal year ended June 30, 2010.

**Legislative joint resolutions fund (LJRF)** – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$664,000) and intergovernmental grants and contributions revenues from the Legislature of the Commonwealth of Puerto Rico. Total revenues and expenditures amounted to \$686,136 each for the fiscal year ended June 30, 2010.

Approximately 98% percent (\$673,918) of LJRF's total revenues for the current fiscal year came from intergovernmental grants and contributions revenues from the Legislature of the Commonwealth of

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Puerto Rico. Approximately 97 percent (\$664,000) of LJRF's total expenditures for the current fiscal year came from capital outlays.

**Debt service fund (DSF)** – The total fund balance of the DSF increased \$181,056 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$696,295, \$514,164 and \$1,075, respectively, for the fiscal year ended June 30, 2010.

Approximately 41 percent (\$282,959) of DSF's total revenues for the current fiscal year came from restricted property taxes, while 59 percent (\$411,467) came from intergovernmental grants and contributions. There was an increase of \$181,056 in the DSF's net change in fund balance when operations for the current fiscal year are compared to those of the prior fiscal year. This occurred because there was an increase in intergovernmental grants and contributions revenues, while property taxes decreased.

**Community development block grant fund (CDBGF)** – The CDBGF's most significant transactions for the current fiscal year are related to program-specific capital grant revenues provided by the U.S. Department of Housing and Urban Development and capital outlays related to the acquisition or construction of major capital facilities, other assets and permanent improvements, incurred to develop viable communities and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

All CDBGF's revenues for the current fiscal year amounting to \$942,363 came from intergovernmental grants and contributions revenues from the U.S. Department of Housing and Urban Development. Approximately 81 percent (\$764,557) of CDBGF's total expenditures for the current fiscal year came from capital outlays.

**Other governmental funds (OGF)** – The total fund balance of the OGF increased by \$49,827 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$934,941, \$909,636 and \$24,522, respectively, for the fiscal year ended June 30, 2010.

Approximately 99 percent (\$934,887) of OGF's total revenues for the current fiscal year came from intergovernmental grants and contributions. Total expenditures (\$855,741) of OGF came from public housing and welfare activities.

#### BUDGETARY HIGHLIGHTS OF GENERAL FUND

The original and final budget of the general fund for the fiscal year ended June 30, 2010 amounted to \$9,936,952. Accordingly, there were no significant changes between the original and the final approved budgets for the fiscal year ended June 30, 2010.

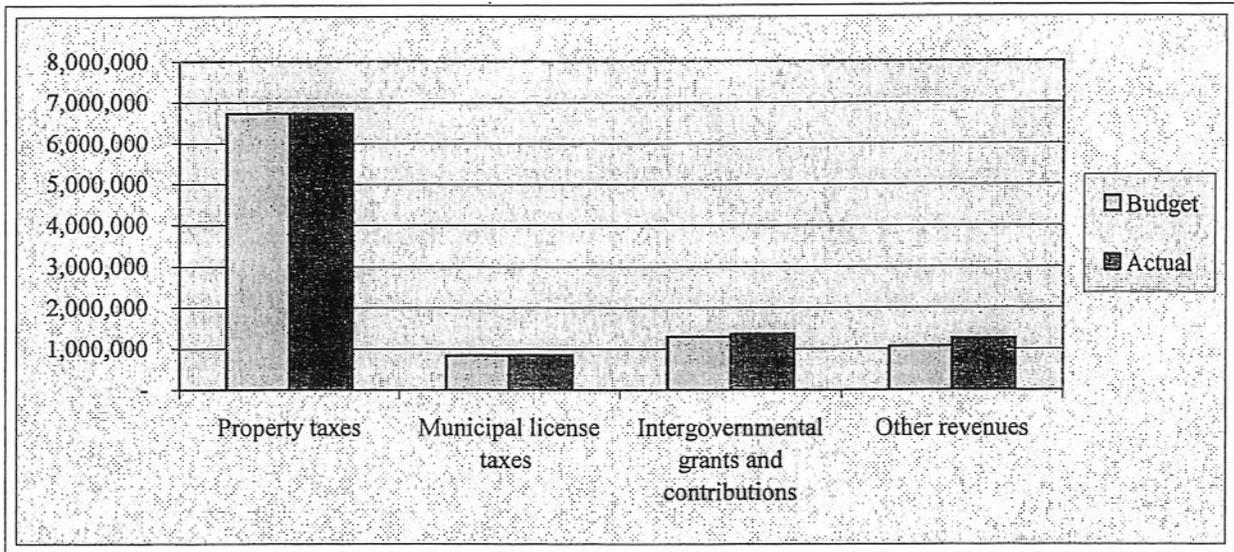
The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2010 were \$10,197,548, which is 3 percent (\$260,596) more than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2010 were \$9,929,550, which is 4 percent (\$397,658) less than the budgeted expenditures. The most significant fluctuations in actual revenues (budgetary basis) occurred with sales and use tax revenues which were \$91,483 more than their respective budgeted amounts. The most significant fluctuations in actual disbursements (budgetary basis) occurred with the general government, which were \$623,325 less than their respective budgeted amounts, respectively.

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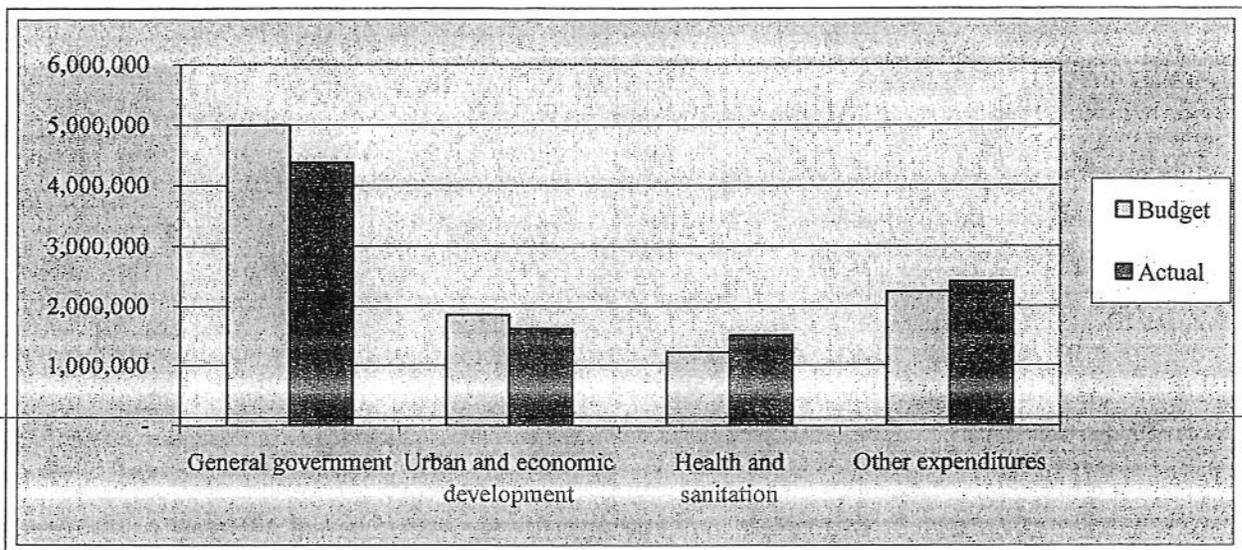
The favorable variance in sales and use tax revenues is mainly due to the increased economic activity in Barranquitas due to a formal economic development strategy implemented by management during the current year and the effect of tax rates lower than those of other municipalities. The favorable variance of \$623,325 in general government expenditures were mainly due to the decrease in operating costs that resulted from a cost reduction program implemented by the Municipality during the current fiscal year.

The following tables summarize the budgetary results of the revenues and expenditures of the general fund for the fiscal year ended June 30, 2010:

***Budgetary Results of Revenues – General Fund***



***Budgetary Results of Expenditures – General Fund***



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## **CAPITAL ASSETS AND DEBT ADMINISTRATION**

### **Capital Assets**

The Municipality has invested \$43,655,957 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$16,503,279 at June 30, 2010. Capital assets increased \$907,867 during the current fiscal year due to the excess of current year additions (\$2,015,966) over depreciation/amortization expense (\$1,108,099) for the fiscal year ended June 30, 2010. The principal additions to capital assets for the current fiscal year were related to construction in progress (1,580,436), machinery, equipment, furniture and fixtures (\$29,620), building, structures and improvements (\$290,578), and land improvements (115,332). The capital additions to construction in progress were principally related to major improvements of streets and roads, the construction of a recreational area and the construction and remodeling of the new city hall.

We encourage readers to consider the information presented here in conjunction with more detailed capital assets information furnished in Note 7 to the accompanying notes to the financial statements.

### **Debt and Long-Term Obligations Administration**

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

At June 30, 2010, the Municipality's total bonded debt amounted to \$6,180,000, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. The Municipality's legal debt margin amounted to \$7,556,548 at the current fiscal year-end. The following is a summary of the principal debt and long-term obligations activity for the fiscal year ended June 30, 2010:

- Bonds payable decreased by \$300,000 due to the effect of the debt service principal payments during the current fiscal year.
- The estimated liability for municipal solid waste landfill closure and post-closure care costs increased by \$426,692 due to the current year provision of such amount charged to health and sanitation expenses.

We encourage readers to consider the information presented here in conjunction with more detailed long-term debt information furnished in Note 9 to the accompanying notes to the financial statements.

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

The territory of Barranquitas covers an area of approximately 33.2 square miles. Barranquitas is a municipality with a population of 31,333 and a population density of 944 habitants per square mile. Barranquitas is characterized by being one of the economic integration centers of the central region of Puerto Rico since it is considered one of the principal source of jobs and services of public administration, education, health, agriculture, manufacturing, food, retailing, construction and commercial industries in the central region of Puerto Rico.

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According to the Puerto Rico Department of Labor and Human Resources, the labor force decreased from 1.41 million in 2009 to 1.39 million in 2010 for Puerto Rico as a whole. In addition, the average unemployment rate increased from 13.1% in 2009 to 14.8% in 2010. In the case of Barranquitas, those statistics indicate that during the fiscal year ended June 30, 2010, there were 438 employers that provided 3,609 jobs in Barranquitas, for an aggregate payroll cost (excluding marginal benefits) of approximately \$18.2 million during the fiscal year then ended.

The principal commercial industry in Barranquitas was the agriculture, which provided 250 jobs from 125 employers during the current fiscal year. However, the public sector provided the majority of jobs during the current fiscal year (41 percent of total jobs), amounting to 1,484 jobs provided by 19 public employers from the Municipality and the government of the Commonwealth of Puerto Rico. Within the public sector, the employees of the Puerto Rico Department of Education and certain private educational entities (including a private university), provided 780 jobs in the education industry during the current fiscal year. Other commercial industries that provided significant amounts of jobs in Barranquitas were the manufacturing and the retailing industries, which provided 252 and 428 jobs, respectively. The average salary per employee amounted to \$20,160 for the fiscal year ended June 30, 2010.

Of the total population of the Municipality, 54 percent or approximately 25,200 persons are considered to live under the poverty level. This rate is higher than the overall rate for Puerto Rico (48 percent). Approximately 40 percent of the population of the Municipality receives public financial assistance as their principal source of income.

The economy of the Municipality is closely linked to the economy of the Commonwealth of Puerto Rico, which ultimately is greatly affected by the condition of the United States of America. Direct investment, exports, transfer payments, interest rates, inflation, and tourist expenditures are exogenous variables that are affected by the economy of the United States of America.

The preliminary reports issued by the Puerto Rico Planning Board (a governmental agency of the Commonwealth of Puerto Rico) about the performance of the economy of the Municipality indicate that the economy decreased 1.8% in terms of total real gross product during the fiscal year ended June 30, 2010.

The Municipality has established policies and programs directed at developing the manufacturing and services industries. Selective tax exemptions and other incentives have stimulated domestic and foreign investment. Infrastructure expansion and modernization have been, to a large extent, financed by bonds issued by the Municipality and certain grants from the U.S. Department of Housing and Urban Development and the Federal Emergency Management Agency. Economic progress has been aided by significant increases in the levels of education and occupational skills of the population of the Municipality.

#### **REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Barranquitas, Department of Finance and Budget, P.O. Box 250, Barranquitas, Puerto Rico, 00794.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Statement of Net Assets  
June 30, 2010

Assets		<u>Governmental activities</u>
<b>Current assets:</b>		
Cash in commercial banks	\$	3,301,462
Account receivable, net of allowance for doubtful accounts:		
Taxes:		
Property taxes	\$ 1,144,706	
Municipal license taxes	5,970	
Construction excise taxes	4,162	
Sales and use tax	48,639	
Intergovernmental grants and contributions	1,121,948	
Other receivable	<u>5,885</u>	
Total accounts receivable, net		2,331,310
Inventories and other current assets		50,193
<b>Restricted assets:</b>		
Cash in commercial banks	\$ 5,667,662	
Cash in fiscal agent	6,312,279	
Property taxes receivable, net of allowance for doubtful accounts	5,821	
Accrued interests on deposits	4,162	
Intergovernmental grants and contributions receivable	<u>453,887</u>	
Total restricted assets		<u>12,443,811</u>
Total current assets		<u>18,126,776</u>
<b>Non-current assets:</b>		
Capital assets, at cost:		
Depreciable capital assets	\$ 36,705,531	
Non-depreciable capital assets	<u>6,950,426</u>	
Total capital assets, at cost	43,655,957	
Less: accumulated depreciation and amortization	<u>(16,503,279)</u>	
Total capital assets, net		27,152,678
Deferred charges, net of accumulated amortization of \$25,191		<u>24,565</u>
Total non-current assets		<u>27,177,243</u>
Total assets	\$	<u><u>45,304,019</u></u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Statement of Net Assets (concluded)  
June 30, 2010

<b>Liabilities and net assets</b>		<u>Governmental activities</u>
<b>Current liabilities (due within one year):</b>		
Accounts payable and accrued liabilities	\$ 765,224	
Intergovernmental payables	<u>1,058,222</u>	
Total accounts payable and accrued liabilities		\$ 1,823,446
Unearned revenues		542,060
Liabilities related to restricted assets:		
Accounts payable and accrued liabilities	410,984	
Accrued interests on bonds payable	84,512	
Unearned revenues	5,551,537	
Current portion of bonds payable	<u>425,000</u>	
Total current liabilities related to restricted assets:		6,472,033
Current portion of long-term obligations:		
Obligations under capital leases	2,925	
Compensated absences	<u>609,973</u>	
Total current portion of long-term obligations		<u>612,898</u>
Total current liabilities		<u>9,450,437</u>
<b>Non-current liabilities, excluding current portion (due in more than one year) :</b>		
Non-current portion of liabilities related to restricted assets - bonds payable		5,755,000
Compensated absences		945,767
Estimated liability for municipal solid waste landfill closure and post-closure care costs		<u>7,771,460</u>
Total non-current liabilities		<u>14,472,227</u>
Total liabilities		<u>23,922,664</u>
<b>Net assets:</b>		
Invested in capital assets, net of related debt		<u>24,843,751</u>
Restricted for:		
Debt service	\$ 1,714,839	
Federal and state funded programs	<u>405,965</u>	
Total restricted net assets		<u>2,120,804</u>
Unrestricted		<u>(5,583,200)</u>
Total net assets		<u>\$ 21,381,355</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Statement of Activities  
Fiscal Year Ended June 30, 2010

Functions/programs	Expenses, including depreciation expense of \$1,108,099	Program revenues			Net revenues (expenses) and changes in net assets
		Charges for services	Program – specific operating grants and contributions	Program – specific capital grants and contributions	
<i>Governmental activities:</i>					
General government	\$ 5,345,287	332,661	-	-	\$ (5,012,626)
Urban and economic development	2,104,213	-	-	942,363	(1,161,850)
Health and sanitation	2,031,413	-	-	-	(2,031,413)
Public safety	1,076,221	-	-	-	(1,076,221)
Public housing and welfare	1,867,859	-	934,887	673,918	(259,054)
Culture, recreation and education	806,191	-	-	-	(806,191)
Interest on long-term obligations	214,725	-	411,467	-	196,742
<b>Total governmental activities</b>	<b>\$ 13,445,909</b>	<b>332,661</b>	<b>1,346,354</b>	<b>1,616,281</b>	<b>(10,150,613)</b>
 General revenues:					
Taxes:					
Property taxes					\$ 7,124,088
Municipal license taxes					840,101
Construction excise taxes					95,809
Sales and use taxes					553,210
Total tax revenues					<u>8,613,208</u>
Intergovernmental grants and contributions, not restricted to specific programs					2,311,272
Interests on deposits					117,778
Miscellaneous revenues					66,990
Total general revenues					<u>11,109,248</u>
Net increase in net assets					<u>958,635</u>
Net assets at beginning of fiscal year					<u>20,422,720</u>
Net assets at end of fiscal year					<u>\$ 21,381,355</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Balance Sheet – Governmental Funds  
 June 30, 2010

	Major governmental funds						Total governmental funds
	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Community development block grant fund	Other governmental funds	
<b>Assets</b>							
Cash in commercial banks	\$ 3,301,462	-	-	-	-	-	\$ 3,301,462
Accounts receivable, net of allowance for doubtful accounts:							
Taxes:							
Property taxes	1,144,706	-	-	-	-	-	1,144,706
Municipal license taxes	5,970	-	-	-	-	-	5,970
Construction excise taxes	4,162	-	-	-	-	-	4,162
Sales and use taxes	48,639	-	-	-	-	-	48,639
Intergovernmental grants and contributions	1,121,948	-	-	-	-	-	1,121,948
Due from other funds	408,802	-	-	-	-	-	408,802
Other receivable	5,885	-	-	-	-	-	5,885
Restricted assets:							
Cash in commercial banks	-	-	4,231,233	-	9,663	1,426,766	5,667,662
Cash in fiscal agent	288,843	3,421,508	-	2,007,922	-	594,006	6,312,279
Property taxes receivable, net of allowance for doubtful accounts	-	-	-	5,821	-	-	5,821
Accrued interests on deposits	-	4,015	-	145	-	2	4,162
Intergovernmental grants and contributions receivable	-	-	-	35,530	402,280	16,077	453,887
Total assets	\$ 6,330,417	3,425,523	4,231,233	2,049,418	411,943	2,036,851	\$ 18,485,385
<b>Liabilities</b>							
Accounts payable and accrued liabilities	\$ 659,028	-	-	-	-	-	\$ 659,028
Intergovernmental payables	1,058,222	-	-	-	-	-	1,058,222
Deferred revenues	604,008	-	-	-	-	-	604,008
Liabilities related to restricted assets:							
Accounts payable and accrued liabilities	-	43,728	13,273	84,512	313,848	40,135	495,496
Due to other funds	-	63,546	64,406	67	98,095	182,688	408,802
Deferred revenues	-	-	4,153,554	-	-	1,397,983	5,551,537
Matured bonds due and payable	-	-	-	250,000	-	-	250,000
Total liabilities	2,321,258	107,274	4,231,233	334,579	411,943	1,620,806	9,027,093
<b>Fund balances</b>							
Reserved for:							
Encumbrances	145,804	-	-	-	-	-	145,804
Debt service	-	-	-	1,714,839	-	-	1,714,839
Capital assets and projects	-	3,318,249	-	-	-	10,080	3,328,329
Advances from other funds	88,675	-	-	-	-	-	88,675
Federal and state funded programs	-	-	-	-	-	405,965	405,965
Unreserved	3,774,680	-	-	-	-	-	3,774,680
Total fund balances	4,009,159	3,318,249	-	1,714,839	-	416,045	9,458,292
Total liabilities and fund balances	\$ 6,330,417	3,425,523	4,231,233	2,049,418	411,943	2,036,851	\$ 18,485,385

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets  
June 30, 2010

The amounts of governmental activities reported in the statement of net assets and the balance sheet-governmental funds are different for the following reasons:

Total fund balances reported in the balance sheet-governmental funds	\$ 9,458,292
Add (Deduct):	
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of \$16,503,279 at June 30, 2010, which is reported in statement of net assets.	27,152,678
Certain deferred revenues reported in the governmental funds are recognized as revenues in the statement of activities. This is the amount of revenues measurable but not available at June 30, 2010 for intergovernmental grants and contributions.	61,948
Debt issued by the Municipality has associated costs (debt issuance costs) that are paid from current available financial resources in the governmental funds. However these costs are deferred in the statement of net assets and reported net of accumulated amortization of \$25,191.	24,565
Inventories and other current assets recorded in the statement of net assets are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds.	50,193
The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2010:	
Bonds payable	(5,930,000)
Obligations under capital leases	(2,925)
Compensated absences	(1,555,740)
Estimated liability for municipal solid waste landfill closure and post-closure care costs	(7,771,460)
Accrued liabilities, principally consisting of employees' Christmas bonuses	(106,196)
Net assets-governmental activities, as reported in the statement of net assets	\$ 21,381,355

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Statement of Revenues, Expenditures and  
Changes in Fund Balances – Governmental Funds  
Fiscal Year Ended June 30, 2010

	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Community development block grant fund	Other governmental funds	Total governmental funds
<b>Revenues:</b>							
Taxes:							
Property taxes	\$ 6,852,276	-	-	282,959	-	-	\$ 7,135,235
Municipal license taxes	840,101	-	-	-	-	-	840,101
Construction excise taxes	95,809	-	-	-	-	-	95,809
Sales and use taxes	553,210	-	-	-	-	-	553,210
Total tax revenues	8,341,396	-	-	282,959	-	-	8,624,355
Intergovernmental grants and contributions	2,311,272	-	673,918	411,467	942,363	934,887	5,273,907
Interests on deposits	55,274	48,363	12,218	1,869	-	54	117,778
Charges for services	332,661	-	-	-	-	-	332,661
Miscellaneous revenues	66,990	-	-	-	-	-	66,990
Total revenues	11,107,593	48,363	686,136	696,295	942,363	934,941	14,415,691
<b>Expenditures:</b>							
Current:							
General government	5,031,580	-	-	-	-	-	5,031,580
Urban and economic development	1,631,069	-	-	-	-	51,895	1,682,964
Health and sanitation	1,517,691	-	-	-	-	-	1,517,691
Public safety	970,636	-	-	-	-	-	970,636
Public housing and welfare	738,322	-	22,136	-	181,749	855,741	1,797,948
Culture, recreation and education	572,138	-	-	-	-	-	572,138
Debt service:							
Principal	2,926	-	-	300,000	-	-	302,926
Interests	561	-	-	214,164	-	-	214,725
Capital outlays	585,409	-	664,000	-	764,557	2,000	2,015,966
Total expenditures	11,050,332	-	686,136	514,164	946,306	909,636	14,106,574
Revenues over (under) expenditures	57,261	48,363	-	182,131	(3,943)	25,305	309,117
<b>Other financing sources (uses):</b>							
Transfers from other funds	95,219	-	-	-	3,943	41,613	140,775
Transfers to other funds	(74,246)	(48,363)	-	(1,075)	-	(17,091)	(140,775)
Total other financing sources (uses), net	20,973	(48,363)	-	(1,075)	3,943	24,522	-
Net increase in fund balances	78,234	-	-	181,056	-	49,827	309,117
Fund balance at beginning of fiscal year	3,930,925	3,318,249	-	1,533,783	-	366,218	9,149,175
Fund balance at end of fiscal year	\$ 4,009,159	3,318,249	-	1,714,839	-	416,045	\$ 9,458,292

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Reconciliation of the Statement of Revenues, Expenditures and  
Changes in Fund Balances – Governmental Funds to the Statement of Activities  
Fiscal Year Ended June 30, 2010

The amounts of governmental activities reported in the accompanying statement of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds, are different for the following reasons:

Total net increase in fund balances reported in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds	\$	309,117
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Add (Deduct):

The following property tax revenues recorded in the statement of activities do not necessarily provide current financial resources, therefore, sometimes are deferred in the governmental funds. This is the net change in deferred revenues of property taxes, for measurable but not available amounts at fiscal year end:

Property taxes		(11,147)
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Governmental funds report capital outlays as expenditures. However in the statement of activities the cost of those assets is capitalized and allocated over their estimated useful lives as depreciation and amortization expense. This is the amount by which capital outlay expenditures (\$2,015,966) exceeded depreciation and amortization expense (\$1,108,099) for the fiscal year ended June 30, 2010.

907,867

Repayment of principal of bonds is reported as an expenditure in the governmental funds, however, the repayment reduces bonds payable in the statement of net assets.

302,926

Amortization of deferred charges reported in the statement of activities does not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds.

(1,493)

Some expenses reported in the statement of activities do not require the use of current financial resources, therefore, are not reported as expenditures in the governmental funds. This consist of the net effect of the current year charges to health and sanitation expenses to increase the estimated liability for municipal solid waste landfill closure and post-closure care costs, the net increase in compensated absences, and other increases and decreases in other accrued liabilities.

(548,635)

Net increase in net assets, as reported in the accompanying statement of activities	\$	<u>958,635</u>
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*The accompanying notes to the basic financial statements are an integral part to this statement.*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2010

**1. Background Information and Summary of Significant Accounting Policies**

The Municipality of Barranquitas (the Municipality) is a local municipal government constituted in 1970 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 No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight 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 legislative power of the Municipality is exercised by the Municipal Legislature, whose members are also elected every four years. The judiciary power is exercised by the General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality.

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

**a) Financial Reporting Model**

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2010, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

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

*RSI*, consisting of a Management's Discussion and Analysis (MD&A), is information presented along with, but separate from, Municipality's basic financial statements.

*MD&A* is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2010, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

Other supplementary information presented in this report for purposes of additional analysis consist of: (1) Budgetary Comparison Schedule – General fund, (2) Schedule of Expenditures of Federal Awards, as listed in the accompanying table of contents.

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On July 1, 2005, the Municipality adopted the provisions of Statement No. 44, *Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1* (GASB No. 44). This statement amended the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, which provides guidance for the preparation of the statistical section of the Municipality's Comprehensive Annual Financial Report (CAFR). Accordingly, the statistical section of this Comprehensive Annual Financial Report has been modified to present more detailed information, typically in ten-year trends, that assists users in utilizing: (1) the basic financial statements, (2) the notes to basic financial statements, and (3) the required supplementary information, to assess the economic condition of a government.

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

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

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

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

**b) Financial Reporting Entity**

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Act No. 81.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

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GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

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

- The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2010.

**c) *Government-wide Financial Statements***

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

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational

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accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

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

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

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

In addition, for the purposes of determining the outstanding debt attributed to capital assets, the following items are excluded from the calculation: (1) bond issuance costs, (2) interest payable, (3) accrued interest on deep discount debt and non-capital accrued liabilities (e.g. compensated absences, claims and judgments, etc.), and (5) debt used to finance capital acquisitions by parties outside the Municipality. Furthermore, the computation of net assets invested in capital assets, net of related debt, excludes inter-fund loans and other financial assets.

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

On July 1, 2005, the Municipality adopted the provisions of Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement clarified that a legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. This Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling

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legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration. Although the determination that a particular restriction is not legally enforceable may cause the Municipality to review the enforceability of other restrictions, it should not necessarily lead the Municipality to the same conclusion for all enabling legislation restrictions.

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

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

The Municipality has reported the following types of restricted net assets in the accompanying statement of net assets as of June 30, 2010:

- (1) **Debt service** – Represent net resources available to cover future debt service payments of bonds payable.
- (2) **Federal and state funded programs** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs.
- **Unrestricted** – Generally, this category consists of the excess of assets over related liabilities that are neither externally nor legally restricted, neither invested in capital assets. However, at June 30, 2010, this category has a negative balance of \$5,583,200 because liabilities exceeded the related assets. Generally, the assets recorded within this category are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category often have constraints that are imposed by management but can be removed or modified.

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

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net assets changed during the fiscal year ended June 30, 2010, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

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

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are classified within the following functions/programs in the accompanying basic financial statements:

*General government:*

Municipal legislature  
Mayor's office  
Department of finance and budget  
Department of human resources  
Department of municipal secretary  
Department of internal audit  
Department of purchasing and supplies

*Urban and economic development:*

Department of public works  
Department of transportation and maintenance  
Department of engineering

*Public safety:*

Department of emergency management  
Department of municipal police

*Health and sanitation:*

Department of recycling and environmental control

*Culture, recreation and education:*

Department of recreation and sports  
Department of culture and tourism

*Public housing and welfare:*

Department of elderly services  
Department of service to citizens

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

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

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The accompanying statement of activities reports the following categories of program revenues for the fiscal year ended June 30, 2010:

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

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes, sales and use taxes and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted interest on deposits, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

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

The effects of all inter-fund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities. Interfund services provided and used have not been eliminated in the process of consolidation.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the GFFS.

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

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

**d) Governmental Fund Financial Statements**

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

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds.

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

The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- **General fund** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Debt service fund** – The debt service fund is a major governmental fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. Consistently with the prior fiscal years' financial statement presentation, during the fiscal year ended June 30,

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2010, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

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

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

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

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

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

By definition, the Municipality's general fund is considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund would be classified as a major governmental fund in the GFFS if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least ten percent (10%) of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing

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sources. Total expenditures for these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund, (2) the debt service fund, (3) the capital improvements bond fund, (4) the legislative joint resolutions fund and (5) the community development block grant fund.

The capital improvements bond fund is a major capital projects fund used to account for the financial resources arising mainly from bond issuance proceeds used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The most significant transactions of this fund are related to capital outlays and proceeds from issuance of bonds.

The legislative joint resolutions fund is a major capital project fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico, which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The most significant transactions of this fund are related to capital outlays and intergovernmental grants and contributions revenues.

The community development block grant fund is a major capital projects fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the U.S. Department of Housing and Urban Development through the Puerto Rico Office of the Commissioner of Municipal Affairs (sub-grantor), which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The most significant transactions of this fund are related to grant revenues and capital outlays incurred to develop viable communities and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

The Municipality periodically undertakes a comprehensive evaluation of its fund structure to ensure that 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 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, the following types of similar internal funds have been combined into single funds in the accompanying fund financial statements:

- The various capital improvement bond issues outstanding have been reported as a single major capital projects fund, the capital improvements bond fund.
- Numerous less-significant capital project and special revenue funds have been combined into single capital project funds and special revenue funds, respectively.
- Program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico have been combined into a single major capital projects fund, the legislative joint resolutions fund.

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

e) *Measurement Focus and Basis of Accounting*

**Government-wide financial statements** – 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 and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

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

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

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

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

Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred 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 assets. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying 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.

**Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal licenses taxes, construction excise taxes, sales and use taxes, interests on deposit, intergovernmental grants and contributions and certain charges for services) to be available if collected within 90 days after June 30, 2010, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2010.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, interest on deposits, and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues (see note 8).

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 and exchange-like transactions are also generally recorded when the exchange takes place.

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

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

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2010.

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. GASBI No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34, and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities. Therefore, the accompanying balance sheet – governmental funds generally reflects 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.

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

- Principal and interest on bonds payable are recorded when they mature (when payment is due), except for principal and interest of bonds due on July 1, 2010, which are recorded as governmental fund liabilities of the debt service fund at June 30, 2010 which is the date when resources were available in the debt service fund.
- Obligations under capital leases, compensated absences, and the estimated liability for municipal solid waste landfill closure and post-closure care costs are recorded only when they mature (when payment is due).

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- Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (unmatured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

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.

*f) Stewardship, Compliance and Accountability*

**Budgetary Control**

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

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

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

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budgets. This permits the Municipality to continue doing payments for its operations and other purposes until the new budgets are approved.

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

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare, capital outlays, principal expenditures, interest expenditures, etc.) within the general and debt service funds, respectively.

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

#### **Budgetary Accounting**

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

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

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

The accompanying statement of revenues and expenditures – budget and actual – budgetary basis – general fund, provides information about the general fund's original budget, its amendments, and the actual results of operations of such governmental fund under the budgetary basis of

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accounting for the fiscal year ended June 30, 2010. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2010, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget at P.O. Box 250, Barranquitas, Puerto Rico 00794.

Because accounting principles applied for the purposes of the developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP, a reconciliation of the differences between the general fund's budgetary basis and GAAP actual amounts is presented as follows:

Excess of revenues and other financing sources over expenditures and other financing uses – budgetary basis – general fund	(\$396,800)
Timing differences:	
Net effect of current year encumbrances recorded as expenditures for budgetary purposes versus prior year encumbrances recorded as current year expenditures for GAAP purposes	685,771
Basis of accounting differences:	
Net decrease in property taxes receivable	23,768
Net decrease in municipal license taxes receivable	(5,912)
Net decrease in construction excise taxes receivable	4,162
Net decrease in sales and use taxes receivable	2,120
Net decrease in intergovernmental receivables	999,575
Net decrease in other receivables	85
Net increase in due and advances from other funds	(55,666)
Net increase in deferred revenues	94,810
Net increase in accounts payable, intergovernmental payables and accrued liabilities	(1,273,679)
Excess of expenditures and other financing uses over revenues and other financing sources general fund– GAAP basis	\$ 78,234

**a) *Unrestricted and Restricted Deposits***

The Municipality's deposits at June 30, 2010 are composed of: (1) demand deposits in commercial banks and (2) demand deposits in the Government Development Bank for Puerto Rico (GDB), fiscal agent.

The Municipality follows the practice of pooling cash. At June 30, 2010, the pool cash account in commercial banks has a balance of \$4,353,216 of which \$3,294,542, \$208,073, \$843,348 and \$7,253 have been recorded in the general fund, the legislative joint resolutions fund, the non-major capital project funds and the non-major special revenue funds, respectively. The balance in the pooled cash account is available to meet current operating requirements and any unrestricted excess, if any, is generally invested in certificates of deposit with commercial banks. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriations.

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

Cash in fiscal agent in the debt service fund consists principally of property tax collections amounting to \$2,007,922 that are restricted for the payment of the Municipality's debt service, as required by law. Cash in fiscal agent of \$288,843 in the general fund consists of program-specific contributions awarded by the Puerto Rico Electric Power Authority that are restricted for the acquisition, construction and improvement of certain minor electrical infrastructure assets. Cash in fiscal agent recorded in the capital improvements bond fund consists mainly of unspent proceeds of bonds amounting to \$3,421,508 that are restricted for the acquisition, construction or improvements of major capital assets. Cash in fiscal agent of \$594,006 other governmental funds consists of program-specific capital grants and contributions awarded by the Commonwealth of Puerto Rico and the Federal Emergency Management Agency that are restricted for the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks in the legislative joint resolutions fund consists of program-specific grants and contributions amounting to \$4,231,233 awarded by the Legislature of the Commonwealth of Puerto Rico that are mainly restricted for the acquisition, construction or improvements of major capital assets. Restricted cash in commercial banks for other governmental funds, amounting to \$1,426,766, represents the balance of interest and non-interest bearing accounts restricted to finance the operations of various federal and state funded programs.

**b) *Unrestricted and Restricted Accounts and Notes Receivable***

Receivables consist of all revenues earned but not collected at June 30, 2010. These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

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

On July 1, 2007, the Municipality adopted the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB No. 48). This Statement establishes standards for the measurement, recognition, and display of transactions where governments exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum. GASB No. 48 provides technical guidance to determine whether this type of transaction should be regarded as a sale or as a collateralized borrowing resulting in a liability. This criteria is used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. Accordingly, GASB No. 48

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establishes that a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving receivables should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the change statements. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

GASB No. 48 also provides guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. According to the criteria set forth by GASB No. 48, there were no transactions involving receivables that should be reported as a sale as of and for the fiscal year ended June 30, 2010, therefore, the adoption of GASB No. 48 had no effect in the accompanying basic financial statements.

*c) Inventories and Other Current Assets*

Inventories consist of construction materials and inventories of office supplies, food and medicines, which are held for consumption. Other current assets consist of prepaid costs. Generally, inventories are capitalized and stated at cost using the first-in, first-out method (FIFO) in the GWFS. Inventories and prepaid expenses in the GFFS are generally recorded as expenditures (purchase method) when purchased (paid) rather than capitalized as an asset.

*d) Deferred Charges*

Deferred charges in the accompanying statement of net assets consist of bond issuance costs, net of accumulated amortization of \$25,191. Deferred charges are amortized over the term of the related debt using the straight-line method. Amortization expense of deferred charges amounted to \$1,493 for the fiscal year ended June 30, 2010. In the GFFS, bond issuance costs are recorded in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

*e) Capital Assets*

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

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In the statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2002 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2002 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

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

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

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20
Machinery and equipment under capital leases	3 to 5

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

**f) *Deferred Revenues***

In the GFFS, deferred revenue arises when one of the following situations occur:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (unavailable revenue). As previously discussed, available is defined as due (or past due) at June 30, 2010 and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria are met, the liability for deferred revenue is removed and revenue is recognized.

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

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

**g) *Compensated Absences***

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2010 and (2) is not contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security taxes and Medicare taxes).

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

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

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

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**h) *Long-term Debt***

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds payable, notes payable, obligations under capital leases, accrued compensated absences, and estimated liabilities for municipal solid waste landfill closure and post-closure care costs.

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All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due on July 1, 2010 are recorded as governmental fund liabilities in the GFFS (debt service fund) when resources are available in the debt service fund (June 30, 2010). In the GFFS, the face amount of debt issued (gross debt reported) is reported as other financing sources when issued.

In the GWFS debt issuance costs are reported as deferred charges, which are amortized under the straight-line method over the life of the debt, while in the GFFS such costs are recognized as expenditures during the current period.

*i) Leases*

The Municipality classifies its lease agreements either as operating or capital leases according to Statement No.13, *Accounting for Leases*, issued by FASB (FASB No. 13). Capital lease agreements are generally non-cancelable and involve substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease obligation at the inception of the lease. According to FASB No. 13, the Municipality classifies a lease agreement as a capital lease if at its inception the lease meets one or more of the following four criteria:

- By the end of the lease term, ownership of the leased property is transferred to the Municipality.
- The lease agreement contains a bargain purchase option.
- The lease term is substantially equal (75 percent or more) to the estimated useful life of the leased property.
- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90 percent or more of the estimated fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond one fiscal year, most capital lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have a fiscal funding or a cancellation clause have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered remote. The Municipality's lease agreements do not include contingent rental payments nor escalation clauses.

In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executor costs and profit thereon to be paid by the lesser. A portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease obligation using the effective interest method.

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In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as: (1) expenditures and (2) other financing sources. Minimum lease payments are recorded as expenditures in the GFFS.

**j) *Municipal Solid Waste Landfill Closure and Post-Closure Care Costs***

Solid waste landfill closure and post-closure maintenance care costs are accounted for following the provisions of GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs* (GASB No. 18).

According to GASB No. 18, the estimated liability for solid waste landfill closure and post-closure care costs (including monitoring and maintenance) include an estimate of all costs to be incurred near or after the close of the Municipality's solid waste landfill under the accrual basis of accounting. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on future closure and post-closure care costs that will be incurred during operation and will continue after the date the landfill no longer accepts waste.

In the accompanying government-wide statement of net assets, this liability is recognized over the useful life of the landfill, even though such costs will only be incurred, by definition, near or after the close of the landfill. The estimates of closing and post closing costs are made using current costs (costs that would be incurred if the closing date of the landfill would have been June 30, 2010). The liability is adjusted annually to reflect the effects of inflation, advances in technology, changes in regulations or similar changes.

At the governmental funds' level, landfill closure and post-closure care costs are recorded in the statement of revenues, expenditures and changes in fund balances – governmental funds as expenditures in the accounting period in which the liability is incurred.

**k) *Accounting for Pension Costs and Post-Employment Benefits***

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

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

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On July 1, 2007, the Municipality adopted the provisions of GASB Statement No. 50, *Pension Disclosures* (GASB No. 50). This Statement more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits. Specifically, GASB No. 50 amends GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, by requiring:

- Disclosure in the notes to the financial statements of pension plans and certain employer governments of the current funded status of the plan—in other words, the degree to which the actuarial accrued liabilities for benefits are covered by assets that have been set aside to pay the benefits as of the most recent actuarial valuation date.
- Governments that use the aggregate actuarial cost method to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method as a surrogate; these governments previously were not required to provide this information.
- Disclosure by governments participating in multi-employer cost-sharing pension plans of how the contractually required contribution rate is determined.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB No. 45) establishes standards for the measurement, recognition, and display of expense/expenditures and related liabilities/assets of post-employment benefits other than pensions (OPEB), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local government employers. At June 30, 2010, there were no OPEB plans adopted by the Municipality. Accordingly, during the fiscal year ended June 30, 2010, the Municipality did not incur in any post-employment benefits costs other than pensions, therefore, the adoption of GASB No. 45 had no effect in the accompanying basic financial statements.

**l) Risk Management**

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

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

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The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2010. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

***m) Reservations of Fund Balances***

Reservations of fund balances represent portions of fund balances in the GFFS that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has recorded the following types of reservations of fund balances in the GFFS:

- ***Encumbrances*** – Represent reservations of fund balances for commitments related to unperformed (executory) contracts for goods or services (future expenditures under purchase orders, contracts and other commitments). These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future fiscal years as the goods or services are received.
- ***Debt service*** – Represent fund balances available to cover future debt service payments (principal and interest) on bonds payable, which are accounted for in the debt service fund.
- ***Capital assets and projects*** – Represent the reservation of financial resources to be used for the acquisition, construction or improvement of capital assets under contracts and other commitments.
- ***Advances from other funds*** – Represent the reservation of financial resources set aside for long-term inter-fund receivables, which are not considered current available financial resources at June 30, 2010.
- ***Federal and state funded programs*** – Represent financial resources set aside for use in federal and state grant programs.

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**n) Inter-fund Activities**

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

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

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

**o) Use of Estimates**

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

**p) Future Adoption of Accounting Pronouncements**

The GASB has issued the following statements that have effective dates after June 30, 2010:

- a. GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2010.
- b. GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple Employers Plans* (GASB 57). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2011.
- c. GASB Statement No. 59, *Financial Instruments Omnibus* (GASB 59). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2010.

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

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## 2. Deposits

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

On July 1, 2004, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, and (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 of Puerto Rico, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico*, issued by the Government Development Bank for Puerto Rico as promulgated by Law No. 113 of August 3, 1995. Accordingly, the Municipality is only allowed to invest in obligations of the Commonwealth of Puerto Rico, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments (debt securities) for which credit risk exposure may be significant. Consequently, at June 30, 2010 and for the fiscal year then ended, the Municipality invested only in certificates of deposit in commercial banks, which are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$100,000 per depositor. No investments in debt or equity securities were made during the fiscal year ended June 30, 2010. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2010.
- **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 has no formal policy relating to interest rate risks, however, the Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2010, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. At June 30, 2010, the interest rate risk associated with the Municipality's cash is considered low since the investment portfolio of the Municipality do not include debt securities or any type of investments that could be affected by changes in interest rates.
- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully

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collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits in GDB, amounting to \$6,312,279 at June 30, 2010, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2010. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2010, the custodial credit risk associated with the Municipality's cash is considered low.

- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2010.

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Cash and cash equivalents at June 30, 2010, are classified in the accompanying balance sheet – governmental funds a follows:

	Major governmental funds						Total
	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Community development block grant fund	Other governmental funds	
Unrestricted:							
Cash in commercial banks	\$ 3,301,462	-	-	-	-	-	\$ 3,301,462
Restricted:							
Cash in commercial banks	-	-	4,231,233	-	9,663	1,426,766	5,667,662
Cash in fiscal agent	288,843	3,421,508	-	2,007,922	-	594,006	6,312,279
Total carrying amount of deposits	<u>\$ 3,590,305</u>	<u>3,421,508</u>	<u>4,231,233</u>	<u>2,007,922</u>	<u>9,663</u>	<u>2,020,772</u>	<u>\$ 15,281,403</u>

### 3. Municipal License Taxes

The Municipality is authorized by Act No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Barranquitas. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2010, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess the corresponding municipal license tax by declaring the volume of business through a tax return to be filed every April 15, based on the actual volume of business (revenues) generated in the preceding calendar year. Taxpayers with a sales volume of \$3 million or more must include audited financial statements with their tax return filings. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration on April 15. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5 percent discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred revenues in the GWFS and the GFFS (see note 8). Total municipal license taxes receivable amounted to \$5,970, at June 30, 2010. Unearned (deferred) municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$542,060 at June 30, 2010.

### 4. Property Taxes

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1 of each calendar year: (1) is engaged in trade or business and is the

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owner of personal or real property used in trade or business or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market prices).

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (lien; levy date) and reporting such taxable value through a personal property tax return filed on May 15 (due date and collection date) subsequent to the assessment date. The total personal property tax rate in force at June 30, 2007 was 6.83 percent (of which taxpayers pay 6.63 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed every January 1, (lien; levy date) and is based on estimated current values of the property, deflated to 1957 market prices. Real property taxes are due and collectible on January 1 and July of every fiscal year. The total real property tax rate in force at June 30, 2006 was 8.83 percent (of which 8.63 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

Residential real property occupied by its owner (not engaged in trade or business) is exempt from property taxes only on the first \$15,000 of the assessed value (at 1957 market prices). For exempt amounts, the Department of Treasury assumes the payment of the basic tax (4.00 percent and 6.00 percent for personal and real property, respectively), except for property assessed for less than \$3,500 (at 1957 market prices), for which no payment is made by the Department of Treasury.

Included within the total personal and real property tax rates of 6.83 percent and 8.83 percent, respectively, there is a portion of the tax rate in the amount of 1.40 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

The composition of property taxes receivable and the related deferred revenue is as follows at June 30, 2010:

	<b>Major governmental funds</b>		<b>Total</b>
	<b>General fund</b>	<b>Debt service fund</b>	
Property taxes receivable	\$ 1,144,706	5,821	\$ 1,150,527

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**5. Intergovernmental Receivables and Payables**

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows at June 30, 2010:

	Major governmental funds				Total
	General fund	Debt service fund	Community development block grant fund	Other governmental funds	
<u>Intergovernmental receivables:</u>					
<i>Charges for services:</i>					
Municipality of Orocovis, net of allowance for doubtful accounts of \$77,598	\$ 103,003	-	-	-	\$ 103,003
<i>Grants and contributions:</i>					
Puerto Rico Treasury Department - Christmas bonus reimbursement	61,948	-	-	-	61,948
Commonwealth of Puerto Rico - state sales tax contribution	-	35,530	-	-	35,530
Puerto Rico Electric Power Authority - Contributions in lieu of taxes	956,997	-	-	-	956,997
U.S. Department of Health and Human Services - Elderly nutrition services fund	-	-	-	16,077	16,077
U.S. Department of Housing and Urban Development, through the Puerto Rico Office of the Commissioner of Municipal Affairs	-	-	402,280	-	402,280
Total intergovernmental receivables	<u>\$ 1,121,948</u>	<u>35,530</u>	<u>402,280</u>	<u>16,077</u>	<u>\$ 1,575,835</u>
<u>Intergovernmental payables:</u>					
<i>Utilities and charges for services:</i>					
Puerto Rico Electric Power Authority-Electric Power Consumption	\$ 956,997	-	-	-	\$ 956,997
Puerto Rico General Services Administration	3,536	-	-	-	3,536
Puerto Rico Telephone Company	55,691	-	-	-	55,691
Puerto Rico Water and Sewer Authority	36,058	-	-	-	36,058
Puerto Rico Labor and Human Resources Department	5,940	-	-	-	5,940
Total intergovernmental payables	<u>\$ 1,058,222</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>\$ 1,058,222</u>

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**6. Inter-fund Transactions**

The composition of all inter-fund balances at June 30, 2010 and for the fiscal year then ended is as follows:

	Due/advances from other governmental funds- General fund
<i>Major governmental funds:</i>	
Community development block grant fund	\$ 98,095
Capital improvements bond fund	63,546
Legislative joint resolutions fund	64,406
Debt service fund	67
Other governmental funds	182,688
Total	\$ 408,802

	Transfers from:			
Transfers to:	General fund	Community development block grant fund	Other governmental funds	Total governmental funds
<i>Major governmental funds:</i>				
General fund	\$ 41,579	-	32,667	\$ 74,246
Debt service fund	1,075	-	-	1,075
Capital improvements bond fund	48,363	-	-	48,363
Other governmental funds	4,202	3,943	8,946	17,091
Total	\$ 95,219	3,943	41,613	\$ 140,775

The principal purposes of inter-fund receivables and payables are to recognize in the general fund the outstanding balance of loans receivable granted to the community development block grant fund and other non-major governmental funds to temporarily cover the payroll and other operating costs of several federally and state funded programs amounting to \$98,095 and \$182,688, respectively.

The principal purposes of inter-fund transfers are to recognize routinely transfers of interest income from the debt service fund and the capital improvements bond fund to the general fund amounting to \$1,075 and \$48,363, respectively.

Inter-fund receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2010.

At June 30, 2010, the general fund reported advances (long-term inter-fund receivables) from certain non-major capital projects funds amounting to \$88,675. These advances among governmental funds

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have been reported at June 30, 2010 within due and advances from other funds and are not expected to be repaid within one year after year-end. Accordingly, at June 30, 2010, the general fund reported a reservation of fund balances amounting to \$88,675 to properly disclose the portion of inter-fund receivables that are considered current available financial resources at June 30, 2010.

**7. Capital Assets**

Capital assets activity for the fiscal year ended June 30, 2010:

	Balance at beginning of fiscal year	Additions/ depreciation expense	Balance at ending of fiscal year
<i>Governmental activities:</i>			
<i>Cost basis:</i>			
Capital assets, not being depreciated/amortized			
Land	\$ 2,245,774	-	\$ 2,245,774
Construction in progress	3,124,216	1,580,436	4,704,652
Total capital assets not being depreciated/amortized	5,369,990	1,580,436	6,950,426
Capital assets, being depreciated/amortized:			
Land improvements	2,444,809	-	2,444,809
Buildings, structures, and improvements	10,981,592	290,578	11,272,170
Infrastructure	17,393,383	115,332	17,508,715
Machinery and equipment, and furniture and fixtures	1,613,607	29,620	1,643,227
Equipment held under capital leases	62,177	-	62,177
Licensed vehicles	3,774,433	-	3,774,433
Total capital assets, being depreciated/amortized	36,270,001	435,530	36,705,531
Total cost basis of capital assets	41,639,991	2,015,966	43,655,957
<i>Accumulated depreciation and amortization:</i>			
Land improvements	1,393,254	65,811	1,459,065
Buildings, structures, and improvements	2,843,140	184,343	3,027,483
Infrastructure	6,947,049	473,269	7,420,318
Machinery and equipment, and furniture and fixtures	1,097,205	126,917	1,224,122
Equipment held under capital leases	57,343	-	57,343
Licensed vehicles	3,057,189	257,759	3,314,948
Total accumulated depreciation and amortization	15,395,180	1,108,099	16,503,279
Net capital assets	\$ 26,244,811	907,867	\$ 27,152,678

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Depreciation and amortization expense was charged to functions in the accompanying government - wide statement of activities as follows for the fiscal year ended June 30, 2010:

General government	\$ 293,547
Public safety	84,830
Public housing and welfare	49,430
Health and sanitation	66,639
Urban and economic development	400,297
Culture, recreation and education	213,356
Total depreciation and amortization expense	\$ 1,108,099

**8. Deferred Revenues**

At June 30, 2010, deferred revenues recorded in the GWFS and the GFFS are as follows:

	Major governmental funds					Statement of net assets
	General fund	Legislative joint resolution fund	Debt service fund	Other governmental funds	Total governmental funds	
<i>Measurable and unavailable revenues:</i>						
Intergovernmental grants and contributions	\$ 61,948	-	-	-	61,948	\$ -
Total measurable and unavailable revenues	61,948	-	-	-	61,948	-
<i>Unearned revenues:</i>						
Municipal license taxes	542,060	-	-	-	542,060	542,060
Intergovernmental grants and contributions	-	4,153,554	-	1,397,983	5,551,537	5,551,537
Total unearned revenues	542,060	4,153,554	-	1,397,983	6,093,597	6,093,597
Total deferred revenues	\$ 604,008	4,153,554	-	1,397,983	6,155,545	\$6,093,597

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**9. Long-Term Obligations**

The general long-term debt activity for the fiscal year ended June 30, 2010 is as follows:

	Balance at beginning of fiscal year	Borrowings or additions	Payments or deductions	Balance at end of fiscal year	Balance due within one year
Bonds payable	\$ 6,480,000	-	(300,000)	6,180,000	\$ 425,000
Obligations under capital leases	5,851	-	(2,926)	2,925	2,925
Compensated absences	1,272,687	1,555,740	(1,272,687)	1,555,740	609,973
Estimated liability for municipal solid waste landfill closure and post-closure care costs	7,344,768	426,692	-	7,771,460	-
Total long term obligations	<u>\$ 15,103,306</u>	<u>1,982,432</u>	<u>(1,575,613)</u>	<u>15,510,125</u>	<u>\$ 1,037,898</u>

Historically, the general fund has been used to liquidate compensated absences, obligations under capital leases, and any other long-term liabilities other than bonds.

**a) Debt Limitation**

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

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

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. The Municipality's available legal debt margin amounted to \$7.5 million at June 30, 2010, as published by the Government Development Bank for Puerto Rico.

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**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 of Puerto Rico provide that the Municipality's public debt will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and bond anticipation notes. 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 described in Note 4, the Municipality levies an annual additional special tax of 1.80 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, 2010:

	<b>Outstanding amount</b>
2006 serial bonds for the acquisition of major capital assets, original amount of \$465,000, due in annual principal installments ranging from \$50,000 to \$80,000; plus interests due in semiannually installments at variable rates (4.50% at June 30, 2010) through July 1, 2019	\$ 225,000
1995 serial bonds for the acquisition of major capital assets, original amount of \$515,000, due in annual principal installments ranging from \$5,000 to \$45,000; plus interests due in semiannually installments at variable rates (7.71% at June 30, 2010) through July 1, 2019	325,000
2004 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$725,000, due in annual principal installments ranging from \$15,000 to \$75,000; plus interests due in semiannually installments at variable rates (4.50% at June 30, 2010) through July, 1, 2024	610,000
2002 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$910,000, due in annual principal installments ranging from \$5,000 to \$80,000; plus interests due in semiannually installments at variable rates (4.30% at June 30, 2010) through July 1, 2026	790,000

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1999 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$1,525,000 due in annual principal installments ranging from \$30,000 to \$140,000 plus interests due in semiannually installments at variable rates (4.30% at June 30, 2010) through July 1, 2019	1,030,000
2004 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$235,000, due in annual principal installments ranging from \$5,000 to \$20,000; plus interests due in semiannually installments at variable rates (4.50% at June 30, 2010) through July 1, 2029	210,000
2008 serial bonds for the acquisition of major capital assets, original amount of \$2,905,000, due in annual principal installments ranging from \$20,000 to \$225,000; plus interests due in semiannually installments at variable rates (7.50% at June 30, 2010) through July 1, 2032	2,835,000
2008 serial bonds for the acquisition of major capital assets, original amount of \$200,000, due in annual principal installments ranging from \$5,000 to \$15,000; plus interests due in semiannually installments at variable rates (7.50% at June 30, 2010) through July 1, 2014	155,000
<b>Total general obligation and public improvements bonds</b>	<u><u>\$ 6,180,000</u></u>

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

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

<b>Fiscal year ending June 30</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2011	425,000	224,478	649,478
2012	486,000	211,227	697,227
2013	426,000	204,336	630,336
2014	425,000	197,445	622,445
2015	460,000	128,376	588,376
2016-2020	1,332,000	596,114	1,928,114
2021-2125	1,313,000	513,506	1,826,506
2026-2030	1,313,000	227,551	1,540,551
<b>Totals</b>	<u><u>\$ 6,180,000</u></u>	<u><u>2,303,033</u></u>	<u><u>\$8,483,033</u></u>

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At June 30, 2010, accrued interest payable on bonds amounted to \$84,512. Interest expense and interest paid on bonds amounted to \$174,955,164 and \$81,977, respectively, for the fiscal year ended June 30, 2010.

According to sections 103 and 148 to 150 of the U.S. Internal Revenue Code and sections 1.148 to 1.150 of the U.S. Treasury Regulation, the Municipality's tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2010, the Municipality had no federal arbitrage liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

**c) *Obligations Under Capital Leases***

The Municipality is obligated under various capital lease agreements with third parties for the acquisition of equipment. At June 30, 2010, the capitalized costs and the related accumulated depreciation of the leased equipment amounted to \$62,177 and \$57,343, respectively, which are accounted for as capital assets in the accompanying statement of net assets.

The future minimum capital lease payments are as follows:

	<b>Fiscal year ending June 30,</b>	<b>Amount</b>
	2011	\$ 3,335
Total future minimum lease payments		3,335
Less: amounts representing future interests at a rate of 7.50%		(410)
Present value of minimum lease payments at June 30, 2010		2,925
Less: current portion of obligation under capital leases		(2,925)
Obligation under capital leases, excluding current portion		\$ -

**10. Municipal Solid waste Landfill Closure and Post-closure Care Costs**

The Municipality is legally responsible for closure and post-closure care costs associated with its municipal solid-waste landfill. State and federal laws and regulations require the Municipality 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.

The Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality has recognized an estimated liability of \$7,771,460 in the accompanying government-wide financial statements using current costs allocated based on the actual landfill capacity at June 30, 2010. The portion of the estimated current costs to be incurred in future years is approximately \$5.5 million, which has not been recognized yet in the accompanying government-wide financial statements. The net change in the liability for the fiscal year ended June 30, 2010 was recorded in the accompanying government-

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wide financial statements with a charge to health and sanitation expenses of \$426,692 in the statement of activities. The current costs of landfill closure and post-closure at June 30, 2010 is \$13.2 million.

Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2010, the Municipality's landfill is still operating and its remaining estimated useful life is approximately three (3) years. Approximately 59 percent of the Municipality's total capacity has been used at June 30, 2010. However, the Municipality is currently evaluating alternatives for the expansion of its solid waste landfill. The expansion would extend the useful life for 10 years approximately.

The Municipality is required to demonstrate financial assurance for closure and post-closure care. However, at June 30, 2010, no assets or financial resources have been restricted to cover the future costs associated with closure costs and post-closure care.

The GASB has issued the following statements that have effective dates after June 30, 2010:

- d. GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which is effective for periods beginning after June 15, 2009.
- e. GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which is effective for periods beginning after June 15, 2009.

## 11. Employees' Retirement Systems

### a) *Plan Description*

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

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

- ***Retirement Annuity***

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

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

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

- ***Merit Annuity***

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

- ***Deferred Retirement Annuity***

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

- ***Coordinated Plan***

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

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

- ***Non-Coordinated Plan***

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

- ***Reversionary Annuity***

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

- ***Occupational Disability Annuity***

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

- *Non-occupational Disability Annuity*

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

- *Death Benefits*

*Occupational:*

(a) Surviving spouse – annuity equal to 50 percent of the participating employee's salary at the date of the death.

(b) Children - \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

*Non-occupational:*

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

*Refunds*

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

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

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

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

System 2000 is a hybrid defined contribution plan administered by the Retirement Systems Administration of the Commonwealth of Puerto Rico, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the

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Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

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

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

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

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

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

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

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

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

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**b) Funding Policy**

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

Municipality and other employers      9.28 percent of applicable payroll

Employees:

Coordination plan:                      5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.

Supplementation plan:                8.28 percent of gross salary. This is the only choice available to policemen, firemen and mayors

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

Municipality and other employers      9.28 percent of applicable payroll

Employees:                                5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent of gross salary in excess of \$6,600.

During the fiscal years ended June 30, 2008, 2009 and 2010, the Municipality and the participating employees contributed 100 percent of the required contributions to ERS and System 2000. The combined actual contributions made by the Municipality and its participating employees to ERS and System 2000 (which equal the required contribution amounts) were as follows during the last three fiscal years:

<b>Fiscal year ended June 30,</b>	<b>Employer contributions</b>	<b>Employee contributions</b>
2008	\$ 293,911	\$ 246,888
2009	\$ 322,004	\$ 283,314
2010	\$ 281,638	\$ 247,798

The above actual employer contributions for the fiscal years ended June 30, 2008, 2009, and 2010 include the employer contributions to System 2000 amounting to \$47,024, \$38,690 and \$32,840, respectively. In addition, the above actual employee contributions for the fiscal years ended June 30, 2008, 2009, and 2010 include the employee contributions to System 2000 amounting to \$27,073, \$39,502 and \$29,774, respectively.

The authority under which obligations to contribute to ERS and System 2000 by the plans' members, employers and other contributing entities (i.e., state or municipal contributions) are established or

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may be amended by law by the House of Representatives, the Senate and the Governor of the Commonwealth of Puerto Rico.

Readers can obtain copies of the audited basic financial statements (GAAP basis) of ERS and System 2000 by writing to Mr. Héctor M. Mayol Kauffman, Executive Director of the Retirement Systems Administration of the Commonwealth of Puerto Rico (the entity that administers ERS and System 2000) at PO Box 42003, Minillas Station, Santurce, Puerto Rico 00940.

## 12. Commitments and Contingencies

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Public Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Public Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, the Municipality has not reported liabilities for awarded or anticipated unfavorable judgments as of June 30, 2010. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significant, if any.

The Municipality has reported outstanding encumbrances amounting to \$145,804 in the general fund at June 30, 2010. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

As of June 30, 2010, the Municipality has several outstanding or planned non-cancelable construction projects of which \$2.3 million have been already incurred and paid as of June 30, 2010 and \$0.6 million remains outstanding to incur through the end of each project. These projects are evidenced by contractual commitments with contractors and are accounted for in the capital projects fund.

The Municipality receives financial assistance from the federal Governments of the United States of America and the Commonwealth in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. Disallowance as a result of these audits may become liabilities of the Municipality. The *"Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of OMB Circular A-133"* for the fiscal year ended June 30, 2010, disclosed various instances of noncompliance with applicable laws and regulations and with internal accounting and administrative controls. If expenditures are disallowed due to noncompliance with grant programs regulations, the Municipality may be required to reimburse the grantor the

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disallowed amounts. Management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, if any.

**13. Sales and Use Tax System**

On July 1, 2006, the Legislature of the Commonwealth of Puerto Rico approved Law No. 117, known as *Tax Justice Law of Puerto Rico* (Law No. 117). Law No. 117 established a seven percent (7%) sales and use tax to substantially all products and services sold in Puerto Rico, of which 5.5% represents a state tax and 1.5% represents a municipal tax pertaining to the Municipality. The state tax was effective for substantially all products and services sold starting November 15, 2006. The municipal tax became effective on April 2007 after the approval of the Municipal Legislature. Municipal sales and use taxes revenues recorded in the general fund amounted to \$553,210 for the fiscal year ended June 30, 2010. In addition, at June 30, 2010, the municipal sales and use taxes receivable amounted to \$48,639.

On July 29, 2007, the Legislature of the Commonwealth of Puerto Rico approved Law No. 80 (Law No. 80) to amend the provisions of Law No. 117. The amendments made obligatory the implementation of a uniform sales and use tax of 1.5% in all municipalities of Puerto Rico that as of June 30, 2007 had not approved such kind of tax. The total tax rate of 1.5% is divided as 1.00% to be collected by each municipality and 0.5% is collected by the Puerto Rico Treasury Department. The 0.5% referred to above is being administered by the Government Development Bank for Puerto Rico for the following purposes: (1) 0.2% is deposited in the new "Municipal Debt Service Fund", strictly for granting loans to the municipalities of Puerto Rico, (2) 0.2% for the creation of the "Municipal Development Fund" % to be distributed among all municipalities pursuant to a formula established by Law No. 80, and (3) 0.1% for the creation of the "Permanent Improvements Fund", to be distributed by the Legislature of the Commonwealth of Puerto Rico to carry out public works and permanent improvement projects.

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Statement of Revenues and Expenditures -  
Budget and Actual - Budgetary Basis - General Fund  
Fiscal Year Ended June 30, 2010

	Budgeted amounts		Actual amounts (budgetary basis-Note 1)	Variance with final budget-over (under)
	Original	Final		
<b>Revenues:</b>				
Property taxes	\$ 6,725,631	6,725,632	6,727,234	\$ 1,602
Municipal license taxes	627,200	840,472	846,013	5,541
Construction excise taxes	60,000	83,392	91,647	8,255
Sales and use taxes	300,000	459,607	551,090	91,483
Total tax revenues	<u>7,712,831</u>	<u>8,109,103</u>	<u>8,215,984</u>	<u>106,881</u>
Intergovernmental grants and contributions	1,169,000	1,299,638	1,367,363	67,725
Interests on deposits	150,000	77,101	86,440	9,339
Charges for services	136,500	267,186	332,576	65,390
Miscellaneous	57,500	183,924	195,185	11,261
Total revenues	<u>9,225,831</u>	<u>9,936,952</u>	<u>10,197,548</u>	<u>260,596</u>
<b>Expenditures:</b>				
Current				
General government	4,830,753	4,998,834	4,792,790	(206,044)
Urban and economic development	1,442,950	1,851,618	1,788,255	(63,363)
Health and sanitation	1,206,213	1,232,463	1,600,217	367,754
Public safety	960,448	955,248	971,751	16,503
Public housing and welfare	614,166	695,309	764,510	69,201
Culture, recreation and education	171,301	593,736	573,613	(20,123)
Debt service:				
Principal	-	-	2,926	2,926
Interests	-	-	561	561
Capital outlays	-	-	120,698	120,698
Total expenditures	<u>9,225,831</u>	<u>10,327,208</u>	<u>10,615,321</u>	<u>288,113</u>
Revenues over (under) expenditures	-	(390,256)	(417,773)	(27,517)
<b>Other financing sources (uses):</b>				
Prior year's budgetary cash surplus readjustment	-	390,256	-	(390,256)
Transfers from other funds	-	-	95,219	95,219
Transfers to other funds	-	-	(74,246)	(74,246)
Total other financing sources, net	-	<u>390,256</u>	<u>20,973</u>	<u>(369,283)</u>
Revenues and other financing sources over expenditures and other financing uses	\$ -	-	(396,800)	\$ (396,800)

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

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Schedule of Expenditures of Federal Awards  
June 30, 2010

	<u>Federal CFDA Number</u>	<u>Pass-through Grantor's Number</u>	<u>Expenditures</u>
<b>U.S. Department of Housing and Urban Development</b>			
Section 8 – Housing Choice Voucher	14.871	RQ-060-VO	\$ 693,168
Pass-through of the State-Office of the Department of the Family – Homeless Prevention and Rapid Rehousing Program	14.257 *	2010-000227	26,333
Pass-through of the State-Office of the Municipal Affairs Commissioners – Community Development Block Grant/State – Administer Small Cities	14.228	AB 2010-003299 FC 2010-003546	<u>946,305</u>
Total U.S. Department of Housing and Urban Development			<u>1,665,806</u>
<b>U.S. Department of Agriculture</b>			
Pass-through of the Puerto Rico Elderly Commission – Food Distribution-Child and Adult Care Food Program	10.558	N/A	<u>131,048</u>
Total U.S. Department of Agriculture			<u>131,048</u>
<b>U.S. Department of Energy</b>			
Pass-through of the State-Administration of Energetic Affairs – Energy Efficiency and Conservation Block Grant	81.128 *	0013A-001	<u>29,726</u>
Total U.S. Department of Energy			<u>29,726</u>
Total Federal Financial Assistance			<u>\$ 1,826,580</u>

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\* American Recovery and Reinvestment Act Funds

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Notes to Schedule of Expenditures of Federal Awards  
June 30, 2010

**1. General**

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

**2. Relationship to General Purpose Financial Statements**

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

Expenditures in the Basic Financial Statements

Major Governmental Funds	\$	13,196,938
Nonmajor governmental funds		909,636
		14,106,574
Less: Non-federal expenditures		(12,279,994)
Total expenditures in the Schedule of Federal Awards	\$	1,826,580



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**

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  
June 30, 2010

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and aggregate remaining fund information of the Municipality of Barranquitas of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2010, which collectively comprise the Municipality's financial statements and have issued our report thereon dated December 9, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 Municipality's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be deficiencies, significant deficiencies or material weaknesses, and, therefore, there can be no assurance that all such deficiencies have been identified. We considered the deficiencies described in the accompanying Schedule of Findings and responses to be material weaknesses in internal control over financial reporting as items 10-01 to 10-4.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Barranquitas of the Commonwealth of Puerto Rico financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 10-05 thru 10-07.

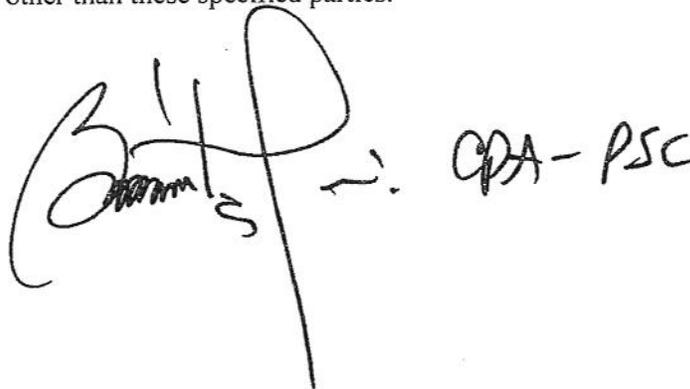
We noted certain matters that we reported to management of the Municipality of Barranquitas of the Commonwealth of Puerto Rico, in a separate letter dated December 9, 2010.

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

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

Toa Alta, Puerto Rico  
December 9, 2010

Stamp No. 2448904  
was affixed to the  
original report.

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



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**

Report on compliance with requirements applicable to each major program and on  
Internal Control over compliance in accordance with OMB Circular A-133  
June 30, 2010

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

Compliance

We have audited the compliance of the Municipality of Barranquitas of the Commonwealth of Puerto Rico (the Municipality) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2010. Municipality's major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality's management. Our responsibility is to express an opinion on Municipality's compliance based on our audit.

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

As described in item 10-05 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with the reporting requirement that is applicable to its Section 8 Housing Choice Vouchers Program. Compliance with such requirement is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

As described in items 10-06 and 10-07 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with the cash management and financial reporting requirements that are applicable to its Section 8 Housing Choice Vouchers Program and its Community Development Block Grant – State Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

In our opinion, except for the instances of noncompliance described in preceding paragraphs, the Municipality of Barranquitas of the Commonwealth of Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2010.

#### Internal Control Over Compliance

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

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and other that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 10-01 to 10-04 to be material weaknesses.

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

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

Toa Alta, Puerto Rico  
December 9, 2010

Stamp No. 2448905  
was affixed to the  
original report.

 CPA-PSC

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Schedule of Findings and Questioned Costs  
 June 30, 2010

**Financial Statements**

Type of auditors' report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness (es) identified?	<u>  X  </u> yes	<u>      </u> no
Significant deficiency (ies) identified not considered to be material weakness?	<u>      </u> yes	<u>  X  </u> none reported
Noncompliance material to financial statements noted?	<u>  X  </u> yes	<u>      </u> no

**Federal Awards**

Internal Control over major programs:		
Material weakness (es) identified?	<u>  X  </u> yes	<u>      </u> no
Significant deficiency (ies) identified not considered to be material weaknesses?	<u>      </u> yes	<u>  X  </u> none reported
Type of auditor's report issued on compliance For major programs:	Qualified	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	<u>  X  </u> yes	<u>      </u> no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
14.228	Community Development Block Grant/Small Cities
14.871	Section 8 Housing Choice Vouchers

Dollar threshold used to distinguish Between Type A and Type B programs:	<u>  \$300,000  </u>
Auditee qualified as low-risk auditee?	<u>      </u> yes <u>  X  </u> no

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Schedule of Findings and Questioned Costs  
June 30, 2010

**Section II – FINANCIAL STATEMENT FINDINGS**

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

**10-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS**

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

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

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

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- The UAS does not have the capabilities of: (1) distinguish between expenditures (expenses) incurred and encumbered, (2) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (3) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (4) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, estimated liability for municipal solid waste landfill closure and post-closure maintenance costs, etc.
- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

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

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

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

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

**CRITERIA:**

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

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

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

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2010 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

**CAUSE AND EFFECT:**

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

**RECOMMENDATION:**

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

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

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

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

#### 10-02 INACTIVE AND UNNECESSARY FUNDS AND INACTIVE BANK ACCOUNTS

The Municipality is maintaining an excessive number of funds and bank accounts that have been inactive for a long period. The accounting records include 27 different funds which amounted to \$4,889,156 and 18 bank accounts with a balance amounting to \$4,038,557, many of which have been inactive or had insignificant movement or operations during the year under audit.

This situation results from the need to analyze and close inactive funds and basic accounts when the fund's objective has been achieved or are no longer of significance. The internal control structure should provide for the accurate maintenance of the books, records, funds and accounts necessary to carry out the Municipality's operations.

#### CRITERIA:

Article 8.007(b) of the Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that funds without specific fiscal years should be closed when the fund's objectives have been completed.

NCGA Statement No. 1, paragraph 4, states that "governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration".

In addition, the recommended practice on "*Improving the Effectiveness of Fund Accounting*" (2004), issued by the Government Finance Officers Association of the United States and Canada (GFOA), states that it is important in this regard to distinguish accounting from financial reporting. Whereas an accounting system must collect all of the data needed to ensure and demonstrate legal compliance, financial reporting is concerned with only those aspects of compliance that are of importance to users of general purpose external financial reports.

#### CAUSE AND EFFECT:

This situation occurred because the Municipality has not analyzed and closed inactive funds and bank accounts when the fund's objectives have been met or are no longer relevant. The continued maintenance of these funds and accounts exposes the Municipality to the unauthorized use of funds from inactive accounts for activities not intended to be financed with these funds. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

#### RECOMMENDATION:

The Municipality should close all unnecessary and inactive funds or accounts. Budgetary balances or deficits remaining in those funds should be investigated and properly closed or established by law. The Municipality should determine whether the intended objectives of these funds were met. For all funds that

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have complied with the requirements, the Municipality should close them. Remaining balances in those funds should be disposed of in accordance with local and federal laws and regulations.

#### **10-03 LACK OF MONITORING AND FRAUD PREVENTION ACTIVITIES**

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

##### **CRITERIA:**

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

##### **CAUSE AND EFFECT:**

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

##### **RECOMMENDATION:**

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

#### **10-04 DEFICIENCIES IN ACCOUNTING RECORDS OF CAPITAL ASSETS**

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

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The Municipality has not performed periodical physical inventories of its capital assets (real property, personal property and infrastructure). As part of the audit, we noted that the Municipality has not completed physical inventory as of June 30, 2010. However, same as in prior fiscal year, an attempt of physical inventory was made, but at report date the physical inventory was not finish, neither reconcile with property register. Accordingly, the capital assets recorded in the accompanying statement of net assets was prepared using financial information obtained from various municipal departments and accounting records outside the official Uniform Accounting System.

The following additional conditions were noted over capital assets:

- The Municipality's capital asset sub-ledger is not reviewed on a regular basis for purposes of identifying and removing those items that have been taken out of service or provide no future benefit. As a result, the capital assets sub-ledger may be misstated for this reason and may not accurately reflect the productive capital assets owned by the Municipality.
- The Municipality does not have formal accounting and control procedures and policies to ensure compliance with GASB 34.
- The subsidiary ledger is not periodically reconciled with the property subsidiary ledgers maintained by the Municipality's several individual federal programs.

**CRITERIA:**

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

In addition, Chapter VII, Section 23, of the *Regulation for Municipal Administration* requires that each Municipality must maintain an adequate control of capital assets through annual physical inventories. In addition, any differences between physical inventory amounts and subsidiary records must be investigated and adjusted. Considering that according to accounting records of the Municipality, the capital assets represent the most significant assets of the Municipality, there is a significant risk of unauthorized use or disposition of capital assets because there are no adequate internal controls in place to ensure accountability of capital assets by department or federal program.

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

- Section 3 establishes that the Finance Director is responsible for the accountability of the capital assets acquired by the Municipality through purchases or donations.

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- Section 4 establishes that the Municipal Property Administrator shall be responsible to the Mayor and the Finance Director for the direct administration, use and maintenance of the entire real and personal property owned by the Municipality.

**COMMONWEALTH OF PUERTO RICO**  
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- Section 14(1) establishes that all municipal property shall be numbered and identified as to ownership by the Municipal Property Administrator.
- Section 15(1) establishes that the Municipal Property Administrator is responsible for accurately maintaining the central property records.
- Section 21(c) establishes that management shall write-off from the property records all property and equipment sold or disposed of when certified by the Internal Auditor of the Municipality upon determination that such disposal is adequate.

**CAUSE AND EFFECT:**

These instances of non-compliance occurred because the Property Division of the Municipality has not enforced the requirement to perform a capital assets inventory and to ensure the proper accountability of capital assets during the fiscal year ended June 30, 2010. Accordingly, the Municipality's internal controls in place over capital assets are not designed to effectively account for capital assets, since it do not allow for the reconciliation of detailed property records with the general ledger. These inadequate property internal controls may expose the Municipality to questioned or disallowed costs by the federal government for lost or stolen property. This condition represents a material weakness in the Municipality's internal controls over financial reporting.

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

**RECOMMENDATION:**

A physical inventory of the Municipality's capital assets should be taken as soon as possible and subsequently on annual basis. Physical inventory amounts should be reconciled with the capital assets recorded in the subsidiary ledgers. Furthermore, the Mayor may issue an executive order to require compliance with this requirement. For these purposes, the Property Division of the Municipality must require from each Municipal Department that acquires or manage capital assets to submit a report including a full description of the asset, location, use, source of funds used to acquire the asset, responsible personnel, cost and any other pertinent data required by state and local regulations. This information should be reconciled with the monthly disbursements (capital outlays) made against the budgetary accounts used for property acquisitions. Sales or other dispositions must also be made only upon approval of the Municipal Property Administrator and the Finance Director, and should be carried out by persons other than the users and through public announcements or bids.

We also recommend that the Municipality implement a formal policy whereby all capital expenditures in excess of an established amount are capitalized with all other amounts charged to operations. This will lead to improved consistency and simplification of accounting records.

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

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

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**Section III - Federal Award Findings and Questioned Costs**

Questioned Cost

Program Findings/Noncompliance Recommendations

Section 8 Voucher  
 CFDA NO. 14.156  
 RQ-46-V060-001-003

**10-05 FINANCIAL REPORTING**

Statement of Condition:

Our review of the Financial Assessment Sub-system, FASS-PH unaudited financial information submitted to the Department of Housing and Urban Development (HUD), disclosed that the information presented in the financial report did not agree with the information recorded in the Program's general ledger, as detailed below.

NONE

<u>Account Name</u>	<u>Amount per Report</u>	<u>Amount per G/L</u>
Administrative Fee Equity	\$ -16,594	\$ 134,870
Housing Assistance Payment Equity	367,037	142,923

Criteria:

OMB Circular A-102, 20 (b) (2) requires recipient of federal funds to have a financial management system that provides for the maintenance of accurate, current and complete records of the financial results of federally assisted activities in accordance with the financial reporting requirements of the Federal Program. The Municipality should prepare federal financial reports based on the Programs underlying accounting records.

Cause and Effect:

This condition occurred because the Office of Federal Programs of the Municipality have not been accounting and reporting the Administrative Fee Equity and Housing Assistance Payments Equity properly.

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

Recommendation:

The Municipality should prepare a roll forward of the equity balances for HAP and Administrative Fee equity. Any material deficiencies by the Municipality may

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require reconciling of prior year data to establish valid equity balances.

SBGP 08  
 CFDA No. 14.228

**10-06 FINANCIAL REPORTING**

Statement of Condition:

Our review of the quarterly financial reports submitted to Office of the Commissioner of Municipal Affairs (OCAM), disclosed that the information presented in the financial reports did not agree with the information recorded in the Program's General Ledger, as detailed below.

NONE

<u>Quarter Ended</u>	<u>Account Name</u>	<u>Amount per Report</u>	<u>Amount per G/L</u>
March 31, 2010			
08-FC-09-002	91.05 Salaries	\$ 20,515	\$ 43,214
	91.31 Social Security	1,569	3,306
	91.51 Workmen Compensation	687	1,447

Criteria:

OMB Circular A-102, 20 (b) (2) requires recipient of federal funds to have a financial management system that provides for the maintenance of accurate, current and complete records of the financial results of federally assisted activities in accordance with the financial reporting requirements of the Federal Program. The Municipality should prepare federal financial reports based on the Programs underlying accounting records.

Cause and Effect:

This condition occurred because the Office of Federal Programs of the Municipality does not reconcile the Program's accounting records with the Municipality official accounting system prior to the preparation of federal reports.

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

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Recommendation:

The Municipality should prepare financial reports based on the Program's underlying accounting records. Any difference should be investigated and reconciled, accordingly.

SBGP  
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**10-07 FEDERAL CASH MANAGEMENT SYSTEM**

Statement of Condition:

NONE

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

a. From 62 request of funds performed during the 2009-2010 fiscal year amounting to \$895,910, 38 (61%) disbursements amounting to \$540,744 maintained a delay of 3 days or more between the funds receipt date and the disbursement date.

Criteria:

Program grant agreement established that "the Municipality minimize the time elapsing between the receipt and the disbursement of funds. Such period shall not exceed three (3) days.

Cause and Effect:

This condition arose because the Municipality has not implemented specific internal controls and procedures designed to minimize the time elapsed between the time when drawdowns are made and the subsequent time when disbursement of federal funds are carried out. This condition increases the risks of avoidable interest income and instances of idle cash balances in the program's bank accounts.

Recommendation:

In accordance with federal regulations, the Municipality should estimate drawdown's of Federal funds as closely as possible to the actual disbursements. The Municipality

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should established procedures to minimize the time  
elapsing between drawdowns and disbursements.

Total questioned costs

\$       -

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Summary schedule of prior years audit findings  
Fiscal Year 2008-2009  
June 30, 2010

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

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2009-2010).
- NR - Not resolved yet. Finding repeated in fiscal year 2009-2010.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
09-01	Deficiencies in the Uniform Accounting System and other Accounting Records	NR
09-02	Inactive and unnecessary funds	NR
09-03	Lack of monitoring and fraud prevention activities	NR
09-04	Deficiencies in accounting record of capital assets	NR

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 Summary schedule of prior years audit findings  
 Fiscal Year 2008-2009  
 June 30, 2010

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

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2009-2010).
- NR - Not resolved yet. Finding repeated in fiscal year 2009-2010.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
09-05	Internal Control	FR
09-06	Financial reporting	FR
09-07	Financial reporting	NR
09-08	Federal cash management system	NR
09-09	Davis-Bacon Act	FR
09-10	Earmarking requirement	FR

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 Summary schedule of prior years audit findings  
 Fiscal Year 2007-2008  
 June 30, 2010

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

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2009-2010).
- NR - Not resolved yet. Finding repeated in fiscal year 2009-2010.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
08-01	Deficiencies in the Uniform Accounting System and other Accounting Records	NR
08-02	Cash and bank accounts	FR
08-03	Personnel files and payroll related procedures	FR
08-04	Inactive and unnecessary funds	NR
08-05	Lack of monitoring and fraud prevention activities	NR

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June 30, 2010

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with the Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2008. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2009-10).
- NR - Not resolved yet. Finding repeated in fiscal year 2009-10.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
08-06	Cash management system	FR
08-07	Eligibility requirement	FR
08-08	Financial reporting	FR
08-09	Federal cash management system	FR
08-10	Federal cash management system	NR
08-11	Federal cash management system	FR
08-12	Davis-Bacon Act	FR
08-13	Earmarking requirement	FR
08-14	Cash management system	FR