

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

**MUNICIPIO DE BARRANQUITAS  
AUDITORÍA 2011-2012  
30 DE JUNIO DE 2012**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS**

**SINGLE AUDIT REPORT  
Fiscal Year Ended  
June 30, 2012**

**BASIC FINANCIAL STATEMENTS AND  
SUPPLEMENTAL SCHEDULE**

With Independent Auditors' Report Thereon  
June 30, 2012

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**Commonwealth of Puerto Rico**  
**Municipality of Barranquitas**  
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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, 2012, 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, 2012, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards we have also issued our report dated November 30, 2012, 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, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting and or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Budgetary Comparison Information on pages 3 through 23 and 78 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States and Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the Municipality. The Schedule of Expenditures and Federal Awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's financial statements. The introductory and statistical sections are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

November 30, 2012  
Toa Alta, Puerto Rico

Stamp No. 2596747  
was affixed to the  
original report.

A handwritten signature in black ink, appearing to be 'Benitez', is written over a large, stylized 'B'. To the right of the signature, the text 'CPA-PSC' is written in a similar handwritten style.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2012

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, 2012. 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 \$26,701,811 at June 30, 2012. The Municipality's net assets increased by \$4,132,138 during the fiscal year ended June 30, 2012.
- The Municipality's assets increased from \$49,956,526 at June 30, 2011 to \$56,450,683 at June 30, 2012, for an increase of \$6,494,157 (13.0% increase).
- The liabilities of the Municipality increased from \$27,386,853 at June 30, 2011 to \$29,748,872 at June 30, 2012, for an increase of \$2,362,019 (8.6% increase).
- The revenues of the Municipality increased from \$15,044,439 for the fiscal year ended June 30, 2011 to \$17,905,342 for the fiscal year ended June 30, 2012, for an increase of \$2,860,903 (19.6% increase).
- The Municipality's expenses decreased from \$13,804,253 for the fiscal year ended June 30, 2011 to \$13,773,204 for the fiscal year ended June 30, 2012, for a decrease of \$31,049 (0.2% decrease).

***Governmental Funds' Highlights:***

- The total fund balances of governmental funds amounted to \$11,758,742 at June 30, 2012, which increased by \$602,658 during fiscal year ended June 30, 2012.
- The total assets of governmental funds decreased from \$21,648,228 at June 30, 2011 to \$21,351,563 at June 30, 2012, for a decrease of \$296,665 (1.4% decrease).
- The governmental fund's total liabilities decreased from \$10,492,144 at June 30, 2011 to \$9,592,821 at June 30, 2012, for a decrease of \$899,323 (8.6% decrease).
- The total revenues of governmental funds increased from \$15,042,184 for the fiscal year ended June 30, 2011 to \$17,520,342 for the fiscal year ended June 30, 2012, for an increase of \$2,478,158 (16.5% increase).
- The governmental fund's total expenditures increased from \$15,015,524 for the fiscal year ended June 30, 2011 to \$18,050,684 for the fiscal year ended June 30, 2012, for an increase of \$3,035,160 (20.2% increase).
- Other net financing sources of governmental funds amounted to \$1,133,000 which are related to the issuance of bonds during the current fiscal year.

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**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, 2012. 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, 2012. 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, 2012, 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 and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. 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 requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-

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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.

**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) Schedule of Federal Awards, and (2) the Budgetary Comparison Schedule – General Fund, 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, 2012 and 2011**

<b>Assets:</b>	<u><b>2012</b></u>	<u><b>2011</b></u>
Current assets	\$ 21,024,504	\$ 20,178,282
Non-current assets:		
Capital assets, net	35,386,243	29,744,970
Other non-current assets	39,936	33,274
Total assets	<u>\$ 56,450,683</u>	<u>\$ 49,956,526</u>
 <b>Liabilities:</b>		
Current liabilities	\$ 8,322,742	\$ 8,575,535
Long-term obligations due within one year	1,400,855	1,244,713
Long-term obligations due after one year	20,025,275	17,566,605
Total liabilities	<u>29,748,872</u>	<u>27,386,853</u>
 <b>Net assets:</b>		
Invested in capital assets, net of related debt	29,870,212	26,884,831
Restricted for debt service and others	2,763,994	2,273,787
Unrestricted	(5,932,395)	(6,588,945)
	<u>\$ 26,701,811</u>	<u>\$ 22,569,673</u>

At June 30, 2012, the Municipality's current assets, amounting to \$21,024,504, are mainly composed of cash in commercial banks and fiscal agent (\$17,906,098), property taxes receivable of \$1,258,965, and intergovernmental receivables of \$1,781,141.

The cash balances include restricted cash of \$12,044,165 which is 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 \$37,225, represents restricted resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

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Fiscal Year Ended June 30, 2012

The Municipality's non-current assets, amounting to \$35,426,179 at June 30, 2012, are substantially composed of capital assets, with a carrying balance of \$35,386,243, net of accumulated depreciation.

During the fiscal year ended June 30, 2012, the assets of the Municipality increased by \$6,494,157 in comparison with the prior fiscal year, principally for the net effect of the following facts:

- Cash in banks increased by \$623,284 mainly due to an increase in the collections of property taxes during the fiscal year ended June 30, 2012.
- Capital assets increased by \$5,641,273 due to the excess of current year additions (\$7,153,702) over depreciation expense (\$1,512,429) for the fiscal year ended June 30, 2012. The principal additions to capital assets for the current fiscal year were related to construction in progress (\$3,721,086), infrastructure (\$2,898,581), and licensed vehicles (\$276,036).

At June 30, 2012, the Municipality's current liabilities amounting to \$9,723,597 are mainly composed of unearned revenues (\$5,065,519), accounts payable and accrued liabilities (\$3,257,223), and the portions due within one year of compensated absences (\$503,900) and bonds payable (\$896,955).

Deferred revenues consist of unearned revenues associated with municipal license taxes (\$148,395) and intergovernmental grants and contributions related to state and federally funded programs (\$4,917,124). As noted in the condensed statement of net assets, the Municipality's current assets exceeded current liabilities by \$11,300,907, for a current ratio (current assets to current liabilities) of 2.16 to 1.00.

The Municipality's non-current liabilities, amounting to \$20,025,275 at June 30, 2012, are composed of portions due after one year of bonds payable (\$7,877,100), compensated absences (\$757,689), and the estimated liability for municipal solid waste landfill closure and post-closure care costs (\$11,390,486).

At June 30, 2012, the liabilities of the Municipality increased by \$2,362,019 in comparison with the prior fiscal year, principally for the following facts:

- The estimated liability for municipal solid waste landfill closure and post-closure care costs increased by \$1,809,513.
- Bonds payable increased by \$748,000 due to the fact that new bonds amounting to \$1,133,000 were issued during the current fiscal year while payments on bonds amounted to \$385,000.
- Unearned revenues decreased by \$1,416,420, which was caused principally by the decrease in unearned grants and contributions of federal and state funded grant award programs.
- Accounts payables to suppliers and accrued liabilities increased by \$683,670 during 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 \$26,701,811 at June 30, 2012. The most significant portion of net assets (\$29,870,212) reflects the Municipality's investment in capital 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

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Fiscal Year Ended June 30, 2012

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, 2012, represents resources that are restricted for debt service payments (\$2,153,109) and the operations of state and federally funded grant award programs and capital projects (\$610,885). The remaining component of total net assets consists of unrestricted negative balance of (\$5,932,395) at June 30, 2012. 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 \$4,132,138 for the fiscal year ended June 30, 2012. Such increase is due to the excess of total revenues (\$17,905,342) over expenses (\$13,773,204) for the fiscal year ended June 30, 2012. This result of operations was caused by the implementation of a formal cost reduction and revenue optimization plan adopted by the Municipality during the current year.

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**MUNICIPALITY OF BARRANQUITAS**  
Management's Discussion and Analysis  
Fiscal Year Ended June 30, 2012

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

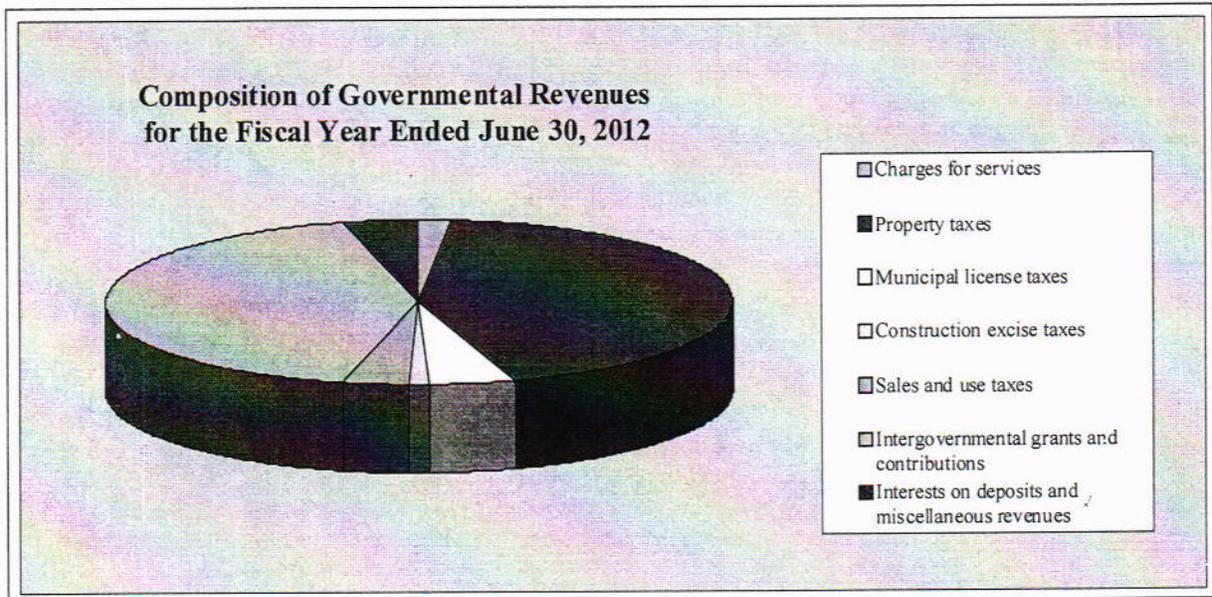
**Comparative Statement of Activities**  
**Governmental Activities (condensed)**  
**Fiscal Years Ended June 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Program revenues:</b>		
Program-specific operating grants and contributions	\$ 1,962,323	\$ 1,332,435
Program-specific capital grants and contributions	5,205,878	2,636,665
Charges for services	312,965	336,605
Total program revenues	7,481,166	4,305,705
<b>General revenues:</b>		
Property taxes	7,783,568	7,458,621
Municipal license taxes	806,500	857,532
Construction excise taxes	188,938	278,496
Sales and use tax	609,653	513,540
Unrestricted grants and contributions	331,879	1,304,471
Interests on deposits and miscellaneous revenues	703,638	326,074
Total general revenues	10,424,176	10,738,734
Total revenues	17,905,342	15,044,439
<b>Program expenses:</b>		
General government	3,707,384	3,944,641
Urban and economic development	2,160,616	2,051,531
Public safety	1,036,471	1,026,379
Health and sanitation	3,545,412	3,646,888
Culture, recreation and education	713,596	734,675
Public housing and welfare	2,292,076	2,164,781
Interest on bonds	317,649	235,358
Total expenses	13,773,204	13,804,253
<b>Net increase in net assets</b>	4,132,138	1,240,186
<b>Net assets, at beginning of fiscal year</b>	22,569,673	21,381,355
<b>Prior period adjustments</b>	-	(51,868)
<b>Net assets, at beginning of fiscal year, as restated</b>	22,569,673	21,329,487
<b>Net assets, at end of fiscal year</b>	\$ 26,701,811	\$ 22,569,673

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As previously mentioned, the Municipality's net assets increased by \$4,132,138 during the current fiscal year. Approximately 52 percent (\$9,388,659) 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 42 percent (\$7,500,080) resulted from intergovernmental grants and contributions.

The following chart presents the composition of revenues for the fiscal year ended June 30, 2012:



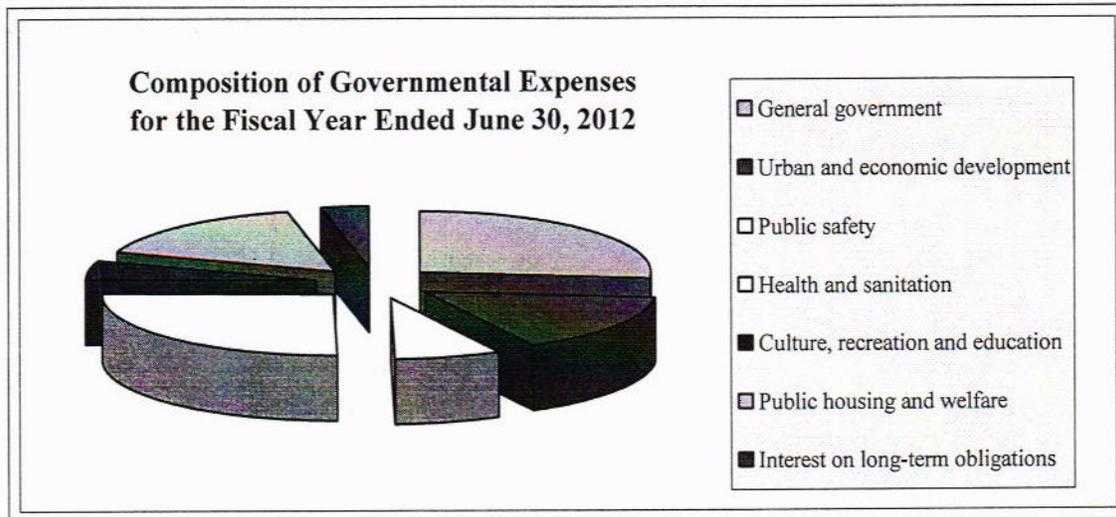
The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2012 were related to: (1) general administrating and operating costs (\$3,707,384), which were classified as "general government", (2) health and sanitation (\$3,545,412), (3) public housing and welfare (\$2,292,076), and (4) urban and economic development (\$2,160,616).

As previously mentioned, the Municipality's expenses decreased from \$13,804,253 for the fiscal year ended June 30, 2011 to \$13,773,204 for the fiscal year ended June 30, 2012, for a decrease of \$31,049. 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 decreased \$237,257 and urban and economic development expenses, which increased \$109,085 during current fiscal year.

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The following chart presents the composition of expenses for the fiscal year ended June 30, 2012:



**Condensed Balance Sheet - Governmental Funds  
June 30, 2012 and 2011**

<b>Assets:</b>	<b>2012</b>	<b>2011</b>
Total assets - major governmental funds	\$ 18,484,169	\$ 19,192,190
Total assets - other governmental funds	2,867,394	2,456,038
Combined assets	<u>\$ 21,351,563</u>	<u>\$ 21,648,228</u>
<b>Liabilities:</b>		
Total liabilities - major governmental funds	\$ 7,394,856	\$ 8,379,361
Total liabilities - other governmental funds	2,197,965	2,112,783
Combined liabilities	<u>9,592,821</u>	<u>10,492,144</u>
<b>Fund balances:</b>		
Non-spendable - general fund	88,675	88,675
Assigned - general fund	651,588	480,428
Restricted - other major governmental funds	4,415,698	5,042,499
Restricted - other governmental funds	669,429	349,310
Unassigned - general fund	5,933,352	5,201,227
Unassigned - other governmental funds	-	(6,055)
Combined fund balances	<u>11,758,742</u>	<u>11,156,084</u>
<b>Total liabilities and fund balances</b>	<u>\$ 21,351,563</u>	<u>\$ 21,648,228</u>

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**FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS**

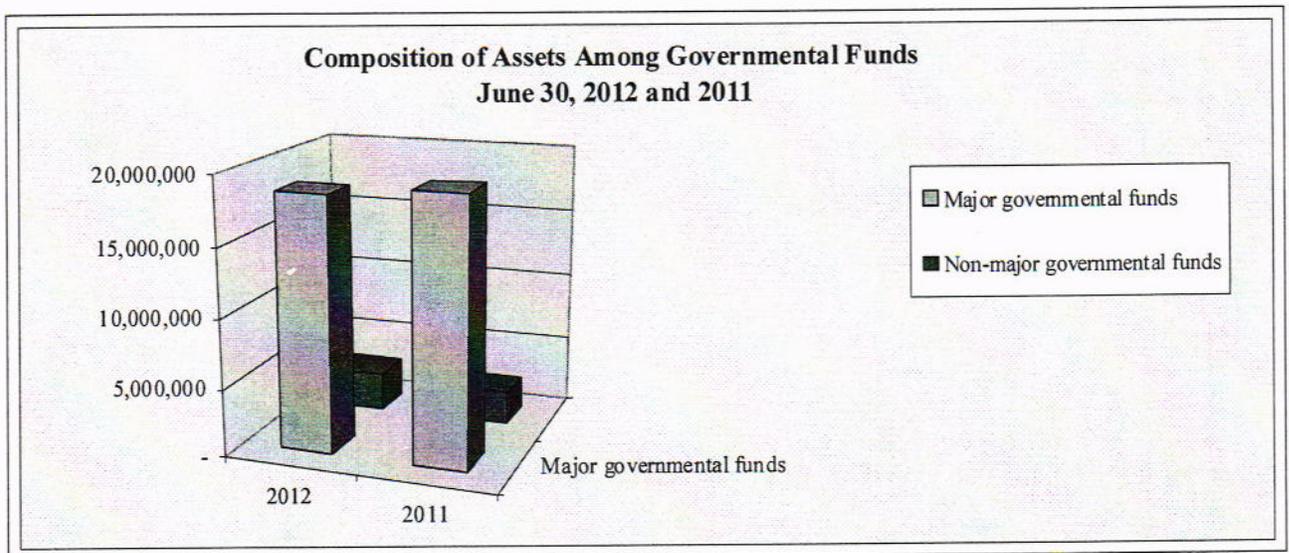
*Analysis of Financial Position of Governmental Funds*

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, 2012, the total assets of governmental funds decreased by \$296,665 in comparison with the prior fiscal year principally for the decrease of \$208,987 in cash in commercial banks and fiscal agent.

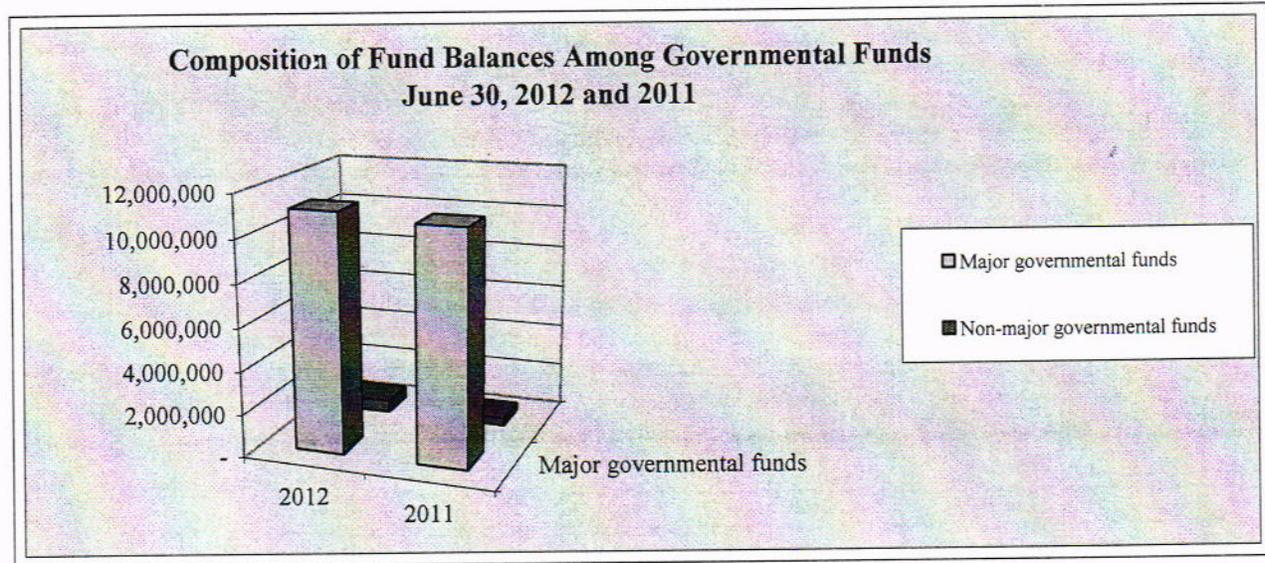
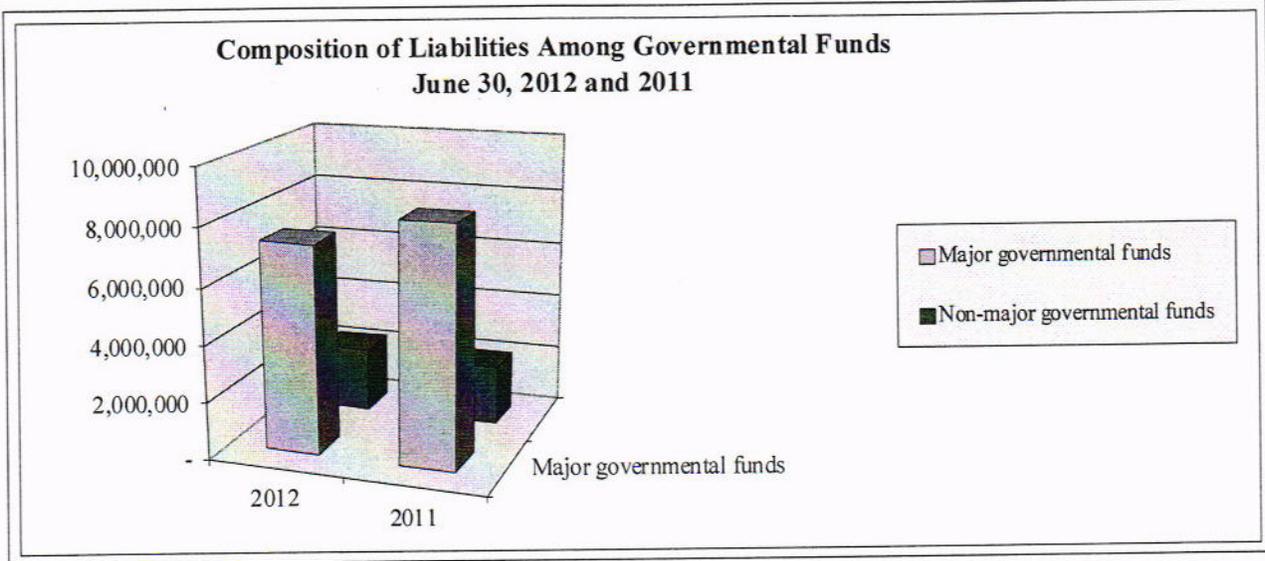
For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most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

At the end of the current fiscal year, total unassigned fund balances of governmental funds amounted to \$5,933,352, while total fund balances reached \$11,758,742. The total fund balances increased by \$602,658 during the current fiscal year. The following tables present the composition of assets, liabilities and fund balances among governmental funds at June 30, 2012 and 2011:



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**COMMONWEALTH OF PUERTO RICO**  
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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 \$9,275,158 at June 30, 2012. Such assets consist principally of: (1) cash in commercial banks and fiscal agent (\$6,150,776), (2) intergovernmental grants and contributions receivable (\$1,508,879), and (3) tax receivables (\$1,221,740).

The GF's total liabilities amounted to \$2,601,543 at June 30, 2012. Such liabilities are composed of: (1) intergovernmental payables (\$1,728,729), (2) deferred revenues (\$597,598), and (3) accounts payable and accrued liabilities (\$275,216).

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At the end of the current fiscal year, unassigned fund balance of the GF's amounted to \$5,933,352, while total fund balance reached \$6,673,615. 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. Unassigned fund balance represents 65 percent of the total GF's expenditures, while total fund balance represents 74 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 \$2,332,525 at June 30, 2012, which consists mainly of restricted cash in fiscal agent (unspent bond proceeds of \$2,321,133). The CIBF's total liabilities amounted to \$69,936 at June 30, 2012, which are mainly composed of: (1) accounts payable and accrued liabilities (\$43,728), and (2) amounts due to other funds (\$26,208). At the end of the current fiscal year, CIBF's total and restricted fund balance reached \$2,262,589.

**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 \$3,809,144 at June 30, 2012, which consists of restricted cash in commercial banks (unspent grant awards and contributions) from the Legislature of the Commonwealth of Puerto Rico amounting to \$3,809,144. The LJRF's total liabilities amounted to \$3,809,144 at June 30, 2012, which are composed principally of deferred grant revenues of \$3,091,173.

**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 \$2,830,284 at June 30, 2012, which consists mainly of restricted cash in fiscal agent (\$2,731,965) and intergovernmental grants and contributions receivable (\$60,890). The DSF's total liabilities amounted to \$677,175 at June 30, 2012, which are mainly composed of: (1) matured bonds due and payable (\$503,900) and (2) accounts payable and accrued liabilities (\$173,193). At the end of the current fiscal year, DSF's total and restricted fund balance reached \$2,153,109.

**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 \$237,058 at June 30, 2012, which consists principally of restricted cash in commercial banks amounting to \$188,094 and grant awards receivable from the U.S. Department of Housing and Urban Development amounting to \$48,954. The CDBGF's total liabilities amounted to \$237,058 at June 30, 2012, which are composed of: (1) accounts payable and accrued liabilities (\$56,055) and (2) amounts due to other funds (\$181,003).

**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 \$2,867,394 at June 30, 2012, which consist mainly of restricted cash in commercial banks and fiscal agent (\$2,704,986). The OGF's total liabilities amounted to \$2,197,965 at

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June 30, 2012, which are mainly composed of deferred revenues (\$1,825,951), accounts payable and accrued liabilities (\$197,079), and short-term and long-term amounts due to other funds (\$174,935).

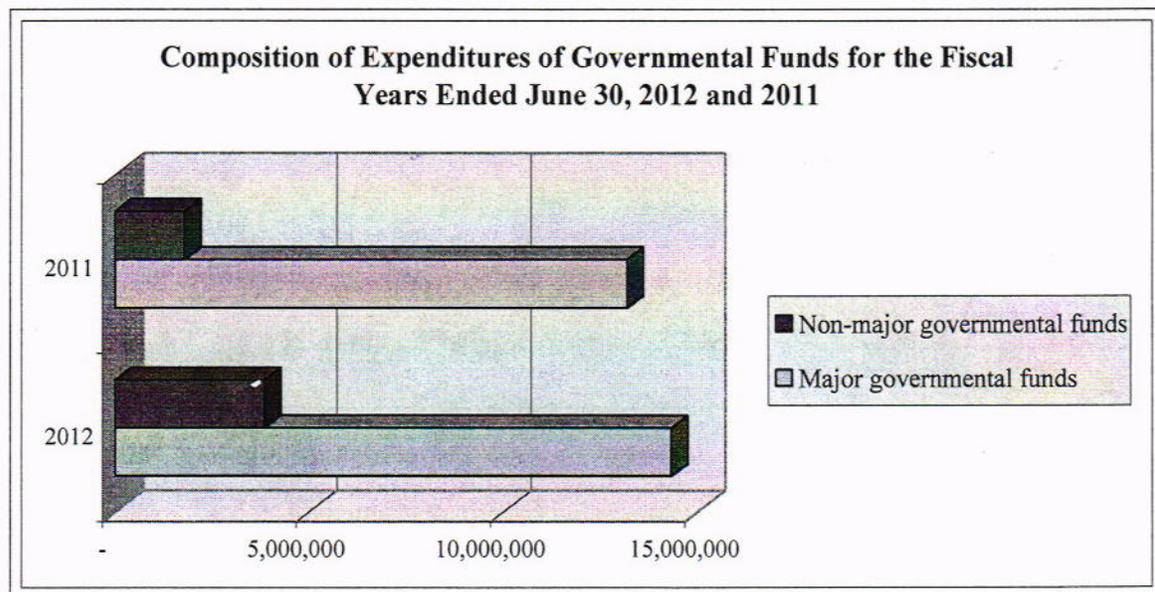
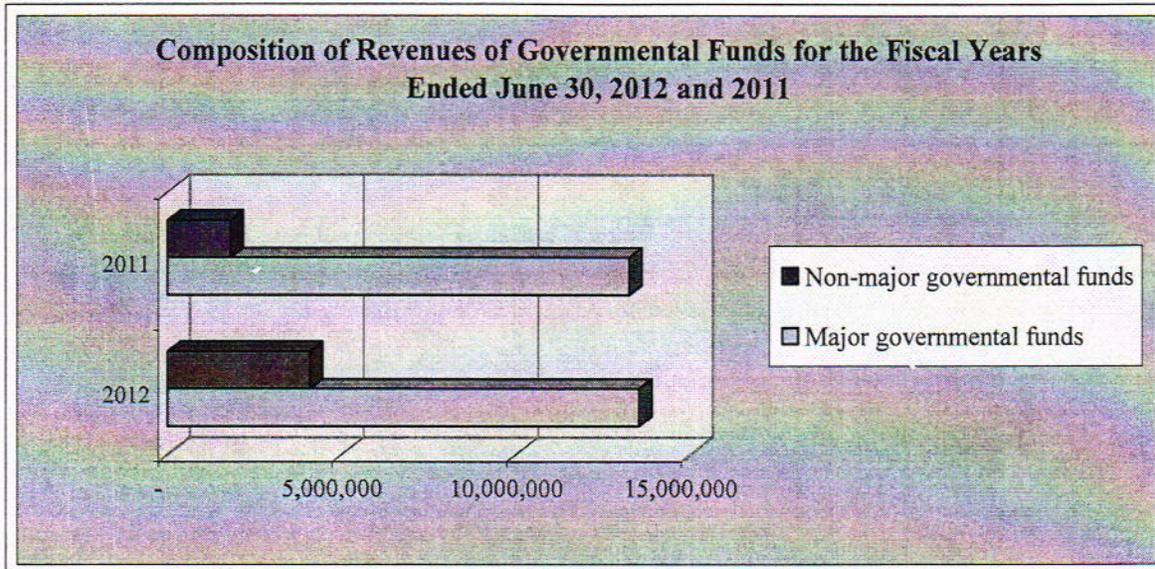
**Condensed Statement of Revenues, Expenditures and  
Changes in Fund Balances -Governmental Funds (condensed)**  
**Fiscal Years Ended June 30, 2012 and 2011**

<b>Revenues:</b>	<u>2012</u>	<u>2011</u>
Total revenues - major governmental funds	\$ 13,503,599	\$ 13,241,711
Total revenues - other governmental funds	4,016,743	1,800,473
Combined total revenues	<u>17,520,342</u>	<u>15,042,184</u>
 <b>Expenditures:</b>		
Total expenditures - major governmental funds	14,380,635	13,210,583
Total expenditures - other governmental funds	3,670,049	1,804,941
Combined total expenditures	<u>18,050,684</u>	<u>15,015,524</u>
 <b>Excess (deficiency) of revenues over (under) expenditures:</b>	<u>(530,342)</u>	<u>26,660</u>
Other financing sources (uses), net - major governmental funds	1,153,520	1,739,454
Other financing sources (uses), net - other governmental funds	(20,520)	(16,454)
Combined other financing sources (uses), net	<u>1,133,000</u>	<u>1,723,000</u>
 <b>Excess of revenues and other financing sources over expenditures and other financing uses</b>	<u>602,658</u>	<u>1,749,660</u>
 <b>Fund balances, at beginning of fiscal year</b>	11,156,084	9,458,292
<b>Prior period adjustments</b>	-	(51,868)
<b>Fund balances, at end of fiscal year, as restated</b>	<u>11,156,084</u>	<u>9,406,424</u>
<b>Fund balances, at end of fiscal year</b>	<u>\$ 11,758,742</u>	<u>\$ 11,156,084</u>

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**Analysis of Operating Results of Governmental Funds**



The following is a detailed analysis of the results of operations of governmental funds for the fiscal year ended June 30, 2012:

**General fund** – The total fund balance of the GF increased \$903,285 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$9,801,408, \$9,066,754 and \$168,631, respectively, for the fiscal year ended June 30, 2012.

Approximately 88 percent (\$8,664,613) 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 3 percent (\$331,879) resulted from intergovernmental grants and contributions.

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During the current fiscal year, there was an excess of revenues and other financing sources over expenditures and other financing uses of \$903,285 in GF, while in the prior fiscal there was an excess of revenues and other financing sources over expenditures and other financing uses of \$1,761,171.

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

- Total revenues decreased \$763,554 (7%) in comparison with the prior fiscal year.
- Total tax revenues decreased \$77,225 (1%) in comparison with the prior fiscal year.
- Intergovernmental grants and contributions decreased by \$970,337 (75%) in comparison with the prior fiscal year.
- Interest on deposits increased \$98,305 during current fiscal year.
- Construction excise taxes decreased \$89,558 (32%) in comparison with the prior fiscal year.
- Sales and use tax increase of \$96,113 is mainly due to an increased monitoring and auditing procedures performed by the Puerto Rico Treasury Department on withholding agents.
- Miscellaneous income increased \$209,343 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 decreased by \$280,844 (8%).

**Capital improvements bond fund (CIBF)** – The most significant transactions of this fund for the current fiscal year are related to capital outlays and interest on deposits. The total fund balance of the CIBF decreased \$839,298 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$156,313, \$1,987,298 and \$991,687, respectively, for the fiscal year ended June 30, 2012. Approximately 99 percent (\$1,979,024) of CIBF's total expenditures for the current fiscal year came from capital outlays.

**Legislative joint resolutions fund (LJRF)** – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$1,685,455) and intergovernmental grants and contributions revenues from the Legislature of the Commonwealth of Puerto Rico (\$1,647,323). Total revenues, expenditures and other financing uses (net) amounted to \$1,711,074, \$1,685,455 and \$25,619, respectively, for the fiscal year ended June 30, 2012.

Approximately 96% percent (\$1,647,323) of LJRF's total revenues for the current fiscal year came from intergovernmental grants and contributions revenues from the Legislature of the Commonwealth of Puerto Rico. All expenditures of the LJRF were related to capital outlays amounting to \$1,685,455 during the current fiscal year.

**Debt service fund (DSF)** – The total fund balance of the DSF increased \$212,497 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$1,034,925, \$821,549 and \$879, respectively, for the fiscal year ended June 30, 2012.

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Approximately 33 percent (\$339,046) of DSF's total revenues for the current fiscal year came from restricted property taxes, while 67 percent (\$693,556) came from intergovernmental grants and contributions. There was an increase of \$212,497 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 and property taxes.

All expenditures of the debt service fund were related to principal and interest expenditures on bonds payable amounting to \$821,549 during the current fiscal year.

**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 \$799,879 came from intergovernmental grants and contributions revenues from the U.S. Department of Housing and Urban Development (\$799,824) and interest on deposits (\$55). Approximately 56 percent (\$456,402) 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 \$326,174 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$4,016,743, \$3,670,049 and \$20,520, respectively, for the fiscal year ended June 30, 2012.

Approximately 99 percent (\$4,012,498) of OGF's total revenues for the current fiscal year came from intergovernmental grants and contributions. Approximately 66 percent (\$2,434,241) of OGF's total expenditures for the current fiscal year came from capital outlay, 28 percent (\$1,010,083) came from public housing and welfare, while 6 (\$225,725) percent came from urban and economic development.

**BUDGETARY HIGHLIGHTS OF GENERAL FUND**

The original and final budget of the general fund for the fiscal year ended June 30, 2012 amounted to \$9,594,962 and \$10,636,988, respectively. However, there was an increase of \$1,042,026 between the original and the final approved budgets for the fiscal year ended June 30, 2012.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$10,762,573 which is 1 percent (\$125,585) more than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$9,634,707, which is 14 percent (\$1,554,281) less than the budgeted expenditures.

The most significant fluctuation in actual revenues (budgetary basis) occurred with the sales and use taxes which were \$98,928 more than their respective budgeted amounts. The increase in such revenues are the direct result of increased monitoring and auditing procedures on substantially all withholding agents located in the Municipality during the current fiscal year and additional collection efforts adopted by the Municipality as part of such process. The increase in these tax revenues is also a direct result of several audits performed by the Puerto Rico Treasury Department on several withholding agents of the Municipality and a formal economic development strategy implemented by management during the current year with the effect of tax rates lower than those of other municipalities.

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The most significant fluctuations in actual expenditures (budgetary basis) occurred with general government expenditures, which had a favorable variance of \$683,951 due to the adoption of a formal cost reduction plan. The cost reduction methods applied are the continuation of a multi-year financial management plan carried out the Department of Finance and Budget to maximize the financial position and liquidity of the Municipality.

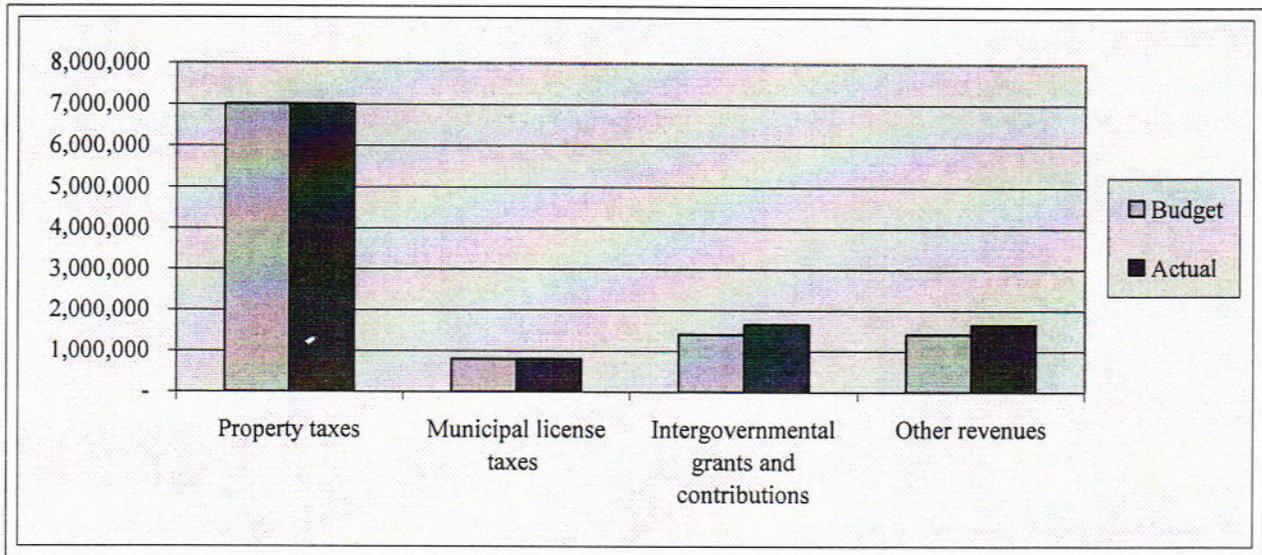
The favorable variance of \$243,706 in the urban and economic development expenditures is also due to the adoption of the multi-year cost reduction and financial management plan referred to above.

The following tables summarize the budgetary results of the revenues and expenditures of the general fund for the fiscal year ended June 30, 2012:

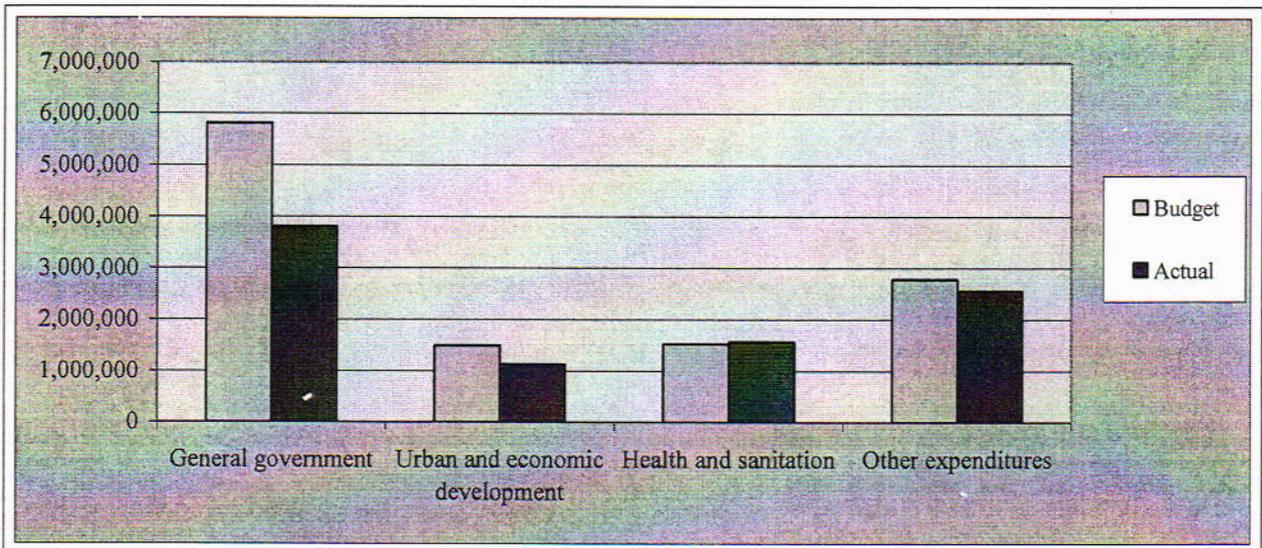
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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Management's Discussion and Analysis  
 Fiscal Year Ended June 30, 2012

*Budgetary Results of Revenues – General Fund*



*Budgetary Results of Expenditures – General Fund*



**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality has invested \$54,713,693 in capital assets used in governmental activities, which have an accumulated depreciation of \$19,327,450 at June 30, 2012. Capital assets increased \$5,641,273 during the current fiscal year due to the excess of current year additions (\$7,153,702) over depreciation expense (\$1,512,429) for the fiscal year ended June 30, 2012. The principal additions to capital assets for the current fiscal year were related to construction in progress (\$3,721,086), and infrastructure

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**MUNICIPALITY OF BARRANQUITAS**  
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(\$2,898,581). The capital additions to infrastructure were principally related to major improvements of streets and roads, the construction of recreational areas.

We encourage readers to consider the information presented here in conjunction with more detailed capital assets information furnished in Note 9 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, 2012, the Municipality's total bonded debt amounted to \$8,381,000, 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 \$5,803,855 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, 2012:

- Bonds payable increased by \$748,000 due to the net effect of a new issuance of bonds (\$1,133,000) and the debt service payments (\$385,000) made during the current fiscal year.
- The estimated liability for municipal solid waste landfill closure and post-closure care costs increased by \$1,809,513 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 11 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 30,673 and a population density of 924 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.

According to the Puerto Rico Department of Labor and Human Resources, the labor force decreased from 1.28 million in 2011 to 1.08 million in 2012 for Puerto Rico as a whole. In addition, the average unemployment rate increased from 15.4% in 2011 to 16.2% in 2012. In the case of Barranquitas, those statistics indicate that during the fiscal year ended June 30, 2012, there were 438 employers that provided 4,800 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 (42 percent of total jobs), amounting to 1,993 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

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**MUNICIPALITY OF BARRANQUITAS**  
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Fiscal Year Ended June 30, 2012

(including a private university), provided 1,075 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 \$20,734 for the fiscal year ended June 30, 2012.

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 increased 0.9% in terms of total real gross product during the fiscal year ended June 30, 2012.

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, 2012

<b>Assets</b>	<b>Governmental activities</b>
<b>Current assets:</b>	
Cash in commercial banks	\$ 5,861,933
Accounts receivable, net of allowance for doubtful accounts:	
Taxes:	
Property taxes	\$ 1,221,740
Intergovernmental grants and contributions	1,508,879
Other receivables	11,535
Total accounts receivable	2,742,154
Inventories and other current assets	55,169
<b>Restricted assets:</b>	
Cash in commercial banks	\$ 5,213,749
Cash in fiscal agent	6,830,416
Property taxes receivable, net of allowance for doubtful accounts	37,225
Accrued interests on deposits	11,596
Intergovernmental grants and contributions receivable	272,262
Total restricted assets	12,365,248
Total current assets	21,024,504
<b>Non-current assets:</b>	
Capital assets, at cost:	
Depreciable capital assets	\$ 43,584,327
Non-depreciable capital assets	11,129,366
Total capital assets, at cost	54,713,693
Less: accumulated depreciation and amortization	(19,327,450)
Total capital assets, net	35,386,243
Deferred charges, net of accumulated amortization of \$28,351	39,936
Total non-current assets	35,426,179
Total assets	\$ 56,450,683

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Statement of Net Assets (concluded)  
June 30, 2012

**Liabilities and net assets**

		<u>Governmental activities</u>
<b>Current liabilities (due within one year):</b>		
Accounts payable and accrued liabilities	\$ 340,468	
Intergovernmental payables	1,728,729	
Total accounts payable and accrued liabilities		\$ 2,069,197
Unearned revenues		148,395
Liabilities related to restricted assets:		
Accounts payable and accrued liabilities	\$ 1,188,026	
Unearned revenues	4,917,124	
Total current liabilities related to restricted assets		6,105,150
Current portion of long term obligations:		
Bonds payable		503,900
Compensated absences		896,955
Total current liabilities		<u>9,723,597</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		7,877,100
Compensated absences		757,689
Estimated liability for municipal solid waste landfill closure and post-closure care cost		11,390,486
Total non-current liabilities		<u>20,025,275</u>
Total liabilities		<u>29,748,872</u>
<b>Net assets:</b>		
Invested in capital assets, net of related debt		<u>29,870,212</u>
Restricted for:		
Debt service	\$ 2,153,109	
Capital projects	425,142	
Federal and state funded programs	185,743	
Total restricted net assets		<u>2,763,994</u>
Unrestricted		<u>(5,932,395)</u>
Total net assets		<u>\$ 26,701,811</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Statement of Activities  
Fiscal Year Ended June 30, 2012

Function / programs	Expenses, including depreciation expense of \$1,512,429	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	\$ 3,707,384	312,965	-	-	\$ (3,394,419)
Urban and economic development	2,160,616	-	1,192,619	3,558,555	2,590,558
Health and sanitation	3,545,412	-	-	-	(3,545,412)
Public safety	1,036,471	-	-	-	(1,036,471)
Public housing and welfare	2,292,076	-	769,704	1,647,323	124,951
Culture, recreation and education	713,596	-	-	-	(713,596)
Interests on bonds payable	317,649	-	-	-	(317,649)
Total governmental activities	<u>\$ 13,773,204</u>	<u>312,965</u>	<u>1,962,323</u>	<u>5,205,878</u>	<u>(6,292,038)</u>
General revenues:					
Taxes:					
Property taxes					\$ 7,783,568
Municipal license taxes					806,500
Construction excise taxes					188,938
Sales and use taxes					609,653
Total tax revenues					<u>9,388,659</u>
Intergovernmental grants and contributions, not restricted to specific programs					331,879
Interests on deposits					441,601
Miscellaneous revenues					262,037
Total general revenues					<u>10,424,176</u>
Net increase in net assets					4,132,138
Net assets at beginning of fiscal year					22,569,673
Net assets at end of fiscal year					<u>\$ 26,701,811</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Balance Sheet – Governmental Funds  
 June 30, 2012

	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	\$ 5,861,933	-	-	-	-	-	\$ 5,861,933
Accounts receivable, net of allowance for doubtful accounts:							
Property taxes receivable	1,221,740	-	-	-	-	-	1,221,740
Intergovernmental grants and contributions	1,508,879	-	-	-	-	-	1,508,879
Due and advances from other funds	382,228	-	-	-	-	-	382,228
Other receivable	11,535	-	-	-	-	-	11,535
Restricted assets:							
Cash in commercial banks	-	-	3,809,144	-	188,094	1,216,511	5,213,749
Cash in fiscal agent	288,843	2,321,133	-	2,731,965	-	1,488,475	6,830,416
Property taxes receivable, net of reserve for doubtful accounts	-	-	-	37,225	-	-	37,225
Accrued interests on deposits	-	11,392	-	204	-	-	11,596
Intergovernmental grants and contributions receivable	-	-	-	60,890	48,964	162,408	272,262
Total assets	\$ 9,275,158	2,332,525	3,809,144	2,830,284	237,058	2,867,394	21,351,563
<b>Liabilities</b>							
Accounts payable and accrued liabilities	275,216	-	-	-	-	-	275,216
Intergovernmental payables	1,728,729	-	-	-	-	-	1,728,729
Deferred revenues	597,598	-	-	-	-	-	597,598
Liabilities related to restricted assets:							
Accounts payable and accrued liabilities	-	43,728	717,971	173,193	56,055	197,079	1,188,026
Due to other funds	-	26,208	-	82	181,003	86,260	293,553
Advances from other funds	-	-	-	-	-	88,675	88,675
Deferred revenues	-	-	3,091,173	-	-	1,825,951	4,917,124
Matured bonds due and payable	-	-	-	503,900	-	-	503,900
Total liabilities	2,601,543	69,936	3,809,144	677,175	237,058	2,197,965	9,592,821
<b>Fund balances</b>							
Nonspendable	88,675	-	-	-	-	-	88,675
Assigned	651,588	-	-	-	-	-	651,588
Restricted	-	2,262,589	-	2,153,109	-	669,429	5,085,127
Unassigned	5,933,352	-	-	-	-	-	5,933,352
Total fund balances	6,673,615	2,262,589	-	2,153,109	-	669,429	11,758,742
Total liabilities and fund balances	\$ 9,275,158	2,332,525	3,809,144	2,830,284	237,058	2,867,394	\$ 21,351,563

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS**

Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets  
June 30, 2012

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

Total fund balances reported in the balance sheet-governmental funds	\$
Add (Deduct):	
<p>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 \$19,327,450 at June 30, 2012, which is reported in statement of net assets.</p>	
<p>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 \$28,351.</p>	
<p>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.</p>	
Revenues related to earned but unavailable property taxes are not deferred for government-wide financial statement reporting.	4
<p>The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2012:</p>	
Accounts payable and accrued liabilities	(6,300)
Bonds payable	(7,870)
Compensated absences	(1,654)
Estimated liability for municipal solid waste landfill closure and post-closure care costs	(11,390)
	(27,214)
Net assets-governmental activities, as reported in the statement of net assets	\$ 26,701,

*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, 2012

	Major governmental funds						Total governmental funds
	General fund	Capital improvements bond fund	Legislative	Debt service fund	Community development block grant fund	Other governmental funds	
			joint resolutions fund				
<b>Revenues:</b>							
Taxes:							
Property taxes	\$ 7,059,522	-	-	339,046	-	-	\$ 7,398,568
Municipal license taxes	806,500	-	-	-	-	-	806,500
Construction excise taxes	188,938	-	-	-	-	-	188,938
Sales and use taxes	609,653	-	-	-	-	-	609,653
Total tax revenues	8,664,613	-	-	339,046	-	-	9,003,659
Intergovernmental grants and contributions	331,879	15,000	1,647,323	693,556	799,824	4,012,498	7,500,080
Interests on deposits	229,914	141,313	63,751	2,323	55	4,245	441,601
Charges for services	312,965	-	-	-	-	-	312,965
Miscellaneous revenues	262,037	-	-	-	-	-	262,037
Total revenues	9,801,408	156,313	1,711,074	1,034,925	799,879	4,016,743	17,520,342
<b>Expenditures:</b>							
Current:							
General government	3,351,761	8,274	-	-	-	-	3,360,035
Urban and economic development	1,192,018	-	-	-	-	225,725	1,417,743
Health and sanitation	1,651,743	-	-	-	-	-	1,651,743
Public safety	951,225	-	-	-	-	-	951,225
Public housing and welfare	813,697	-	-	-	363,177	1,010,083	2,186,957
Culture, recreation and education	507,730	-	-	-	-	-	507,730
Debt service:							
Debt issue costs	-	-	-	-	-	-	-
Principal	-	-	-	503,900	-	-	503,900
Interests	-	-	-	317,649	-	-	317,649
Capital outlays	598,580	1,979,024	1,685,455	-	456,402	2,434,241	7,153,702
Total expenditures	9,066,754	1,987,298	1,685,455	821,549	819,579	3,670,049	18,050,684
Revenues over (under) expenditures	734,654	(1,830,985)	25,619	213,376	(19,700)	346,694	(530,342)
<b>Other financing sources (uses):</b>							
Proceeds on issuance of bonds	-	1,133,000	-	-	-	-	1,133,000
Transfers from other funds	435,047	-	-	-	19,700	220,844	675,591
Transfers to other funds	(266,416)	(141,313)	(25,619)	(879)	-	(241,364)	(675,591)
Total other financing sources (uses), net	168,631	991,687	(25,619)	(879)	19,700	(20,520)	1,133,000
Net increase (decrease) in fund balances	903,285	(839,298)	-	212,497	-	326,174	602,658
<b>Fund balance at beginning of fiscal year</b>	5,770,330	3,101,887	-	1,940,612	-	343,255	11,156,084
<b>Fund balance at end of fiscal year</b>	\$ 6,673,615	2,262,589	-	2,153,109	-	669,429	\$ 11,758,742

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

*OK/ky  
07/03/2012*

**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, 2012

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	\$ 602,658
Add (Deduct):	
Net change in deferred revenues related to property taxes for the fiscal year ended June 30, 2012.	385,000
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 (\$7,153,702) exceeded depreciation and amortization expense (\$1,512,429) for the fiscal year ended June 30, 2012.	5,641,273
Proceeds from issuance of bonds payable are reported as an other financial source in the governmental funds, however, such proceeds increase bonds payable in the statement of net assets.	(1,133,000)
Governmental funds report deferred charges as expenditures. However in the statement of activities the cost of these assets is capitalizaed and amortized. This is the amount by which additions to deferred charges (\$8,274) exceeded the amortization of such assets (\$1,612) for the fiscal year ended June 30, 2012.	6,662
Repayment of principal of long-term liabilities is reported as an expenditure in the governmental funds, however, the repayment reduces bonds payable in the statement of net assets.	503,900
The following 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:	
Net change in estimated liability for municipal solid waste landfill closure and post-closure care costs	(1,809,513)
Net change in accrued compensated absences and others	(64,842)
Net increase in net assets, as reported in the accompanying statement of activities	<u>\$ 4,132,138</u>

*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, 2012

**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, 2012, 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, 2012, 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 consists of: (1) Schedule of Expenditures of Federal Awards and (2) the Budgetary Comparison Schedule – General Fund, as listed in the accompanying table of contents.

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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, 2011, and have not affected the financial positions and the results of operations reported as of and for the fiscal year ended June 30, 2012. Accordingly, the accompanying GFFS have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2011.

**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.

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

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Fiscal Year Ended June 30, 2012

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.

On July 1, 2011, the Municipality adopted the provisions of GASB Statement No. 61, *The Financial Reporting Entity: Omnibus-an amended of GASB Statement No. 14 and No. 34* (GASB No. 61). GASB No. 61 modified certain requirements for inclusion of component units in the financial reporting entity.

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, 2012.

**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 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.

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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 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.

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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, 2012:

- (1) **Debt service** – Represent net resources available to cover future debt service payments of bonds payable.
  - (2) **Capital projects** – Represent net resources available to cover the cost of the acquisition, construction and improvement of major capital assets.
  - (3) **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, 2012, this category has a negative balance of \$5,757,623 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, 2012, 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 are classified within the following functions/programs in the accompanying basic financial statements:

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***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.

The accompanying statement of activities reports the following categories of program revenues for the fiscal year ended June 30, 2012:

- **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.

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- **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 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.

COMMONWEALTH OF PUERTO RICO  
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Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2012

**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. On July 1, 2010, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54), which modified the interpretations of certain terms within the definition of the special revenue funds and the types of activities the Municipality may choose to report in those funds. GASB 54 also clarified the capital projects fund type definition for better alignment with the needs of preparers and users. Definitions of other governmental fund types also were also modified for clarity and consistency.

Pursuant to the provisions set forth by GASB 54, the Municipality reported the following governmental funds in the accompanying GFFS:

- **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

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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, 2012, 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 major and 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 in the accompanying financial statements 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

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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 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.

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- 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.

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)

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in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

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, 2012, 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, 2012.

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 10).

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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.

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, 2012.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. 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, 2012, which are recorded as governmental fund liabilities of the debt service fund at June 30, 2012 which is the date when resources were available in the debt service fund.

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- 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).
- 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

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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 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.

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The accompanying Budgetary Comparison Schedule – 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 accounting for the fiscal year ended June 30, 2012. 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, 2012, 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	\$ 1,296,498
Timing difference - net effect of current year encumbrances recorded as expenditures for budgetary purposes versus prior year encumbrances recorded as current year expenditures for GAAP purposes	929,331
Basis of accounting differences (net changes in the following assets and liabilities):	
Property taxes receivable	54,184
Municipal license taxes receivable	(902)
Intergovernmental grants and contributions receivable	346,852
Other receivables	6,032
Due and advances from other funds	(1,149,381)
Deferred revenues	(17,478)
Accounts payable, accrued liabilities and intergovernmental payables	(561,851)
Excess of revenues and other financing sources over expenditures and other financing uses, general fund– GAAP basis	\$ 903,285

**g) *Unrestricted and Restricted Deposits***

The Municipality’s deposits at June 30, 2012 are composed of: (1) demand deposits in commercial banks and (2) demand deposits in the Government Development Bank for Puerto Rico (GDB), fiscal agent.

Cash in commercial banks of \$5,861,933 in the general fund is available to meet current operating requirements of the Municipality and any excess, if any, is generally invested in certificates of deposit in commercial banks.

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

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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 \$2,731,965 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 \$2,321,133 that are restricted for the acquisition, construction or improvements of major capital assets. Cash in fiscal agent of \$1,488,475 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 unspent program-specific grants and contributions amounting to \$3,809,144 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 \$1,216,511, represents the balance of interest and non-interest bearing accounts restricted to finance the operations of various federal and state funded programs.

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

Receivables consist of all revenues earned but not collected at June 30, 2012. 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 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

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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, 2012, therefore, the adoption of GASB No. 48 had no effect in the accompanying basic financial statements.

*i) 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.

*j) Deferred Charges*

Deferred charges in the accompanying statement of net assets consist of bond issuance costs, net of accumulated amortization of \$28,351. Deferred charges are amortized over the term of the related debt using the straight-line method. Amortization expense of deferred charges amounted to \$1,612 for the fiscal year ended June 30, 2012. In the GFFS, bond issuance costs are recorded in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

*k) 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).

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

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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.

***l) 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, 2012 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.
- 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.

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

***m) 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, 2012 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.

***n) 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.

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,

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2012 are recorded as governmental fund liabilities in the GFFS (debt service fund) when resources are available in the debt service fund (June 30, 2012). 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.

*o) Leases*

The Municipality classifies its lease agreements either as operating or capital leases. 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. 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.

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.

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**p) *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 care costs are made using current costs (costs that would be incurred if the closing date of the landfill would have been June 30, 2012). 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.

**q) *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.

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*

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*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, 2012, there were no OPEB plans adopted by the Municipality. Accordingly, during the fiscal year ended June 30, 2012, 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.

**r) 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.

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

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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, 2012. 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.

s) ***Fund Balances***

On July 1, 2010, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB 54, the accompanying GFFS report fund balance amounts that are considered non-spendable since are net resources that cannot be spent readily with cash or are legally or contractually required not to be spent. At June 30, 2012, such fund balances are related to long-term interfund loans receivable recorded in the general fund amounting to \$88,675.

Other fund balances in the accompanying basic financial statements have been reported as restricted, assigned, or unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- a. *Restricted* – Represent net resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers. In the accompanying basic financial statements, restricted fund balances have been reported in the following funds and for the following purposes:
  - *Capital improvements bond fund* – restricted fund balance consist of financial resources to be used only for the acquisition, construction or

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improvement of capital assets under contracts and other commitments, as approved and financed by the Government Development Bank for Puerto Rico.

- *Legislative joint resolutions fund* – restricted fund balance consist of financial resources arising from grants and contributions received through resolutions of the Legislature of the Commonwealth of Puerto Rico to be used principally for the acquisition, construction or improvement of capital assets under contracts and other commitments.
  - *Debt service fund* – restricted fund balance consist of financial resources available only to cover future debt service payments (principal and interest) on bonds payable, which are accounted for in the debt service fund, as required by Law.
  - *Community development block grant fund* – restricted fund balance consist of 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 restricted for the acquisition or construction of major capital facilities, other assets and permanent improvements in benefit of low-income and moderate-income communities.
  - *Other governmental funds* – restricted fund balance consist of financial resources arising from operating and capital grants and contributions from state and federal grantors that can be spent only for the specific purposes stipulated by the respective external resource providers, or through enabling legislation.
- b. *Assigned* – Represent net resources recorded in the general fund intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.

At June 30, 2012 assigned fund balances in the general fund consist of fund balances reserved for encumbrances amounting to \$651,588.

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

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

The Municipality had no fund balances classified as *committed* at June 30, 2012. Those types of fund balances are generally related to financial resources used for specific purposes, imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances), which would only be changed by a similar law, ordinance or resolution.

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2012.

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

The classification of the Municipality's individual governmental funds among general, debt service, special revenue and capital project fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB 54. In addition, the financial positions and the results of operations reported in the accompanying GFFS as of and for the fiscal year ended June 30, 2012 have not been affected for this change in accounting principle. Accordingly, the accompanying GFFS have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2011.

**t) *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

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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.

**u) 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.

**v) Future Adoption of Accounting Pronouncements**

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

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB No. 62). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2012.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of resources, Deferred Inflows of Resources, and Net Position* (GASB No. 63). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2012.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of ASB Statement No. 53* (GASB No. 64). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2011.
- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB No. 65). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2013.
- GASB Statement No. 66, *Technical Corrections – 2012 – an amendment of GASB Statement No. 10 and No. 62* (GASB No. 66). The requirements of this Statement are effective for the fiscal year commencing on July 1, 2013.

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, 2012 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 \$250,000 per depositor. No investments in debt or equity securities were made during the fiscal year ended June 30, 2012. 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, 2012.
- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality 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, 2012, (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, 2012, 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 \$250,000 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 \$6,830,416 at June 30, 2012, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2012. 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, 2012, 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, 2012.

Cash and cash equivalents at June 30, 2012, are classified in the accompanying balance sheet – governmental funds as 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	\$ 5,861,933	-	-	-	-	-	\$ 5,861,933
Restricted:							
Cash in commercial banks	-	-	3,809,144	-	188,094	1,216,511	5,213,749
Cash in fiscal agent	288,843	2,321,133	-	2,731,965	-	1,488,475	6,830,416
Total carrying amount of deposits	<u>\$ 6,150,776</u>	<u>2,321,133</u>	<u>3,809,144</u>	<u>2,731,965</u>	<u>188,094</u>	<u>2,704,986</u>	<u>\$ 17,906,098</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, 2012, 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

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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). Unearned (deferred) municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$529,890 at June 30, 2012.

Municipal license tax revenues amounted to \$806,500 for the fiscal year ended June 30, 2012, which has been recorded in the general fund since is available for general operating purposes.

**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 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, 2012 was 6.28 percent (of which taxpayers pay 6.08 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, 2012 was 8.28 percent (of which 8.08 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 6.28 percent and 8.28 percent, respectively, there is a portion of the tax rate in the amount of 1.05 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

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The composition of property taxes receivable is as follows at June 30, 2012:

	<b>Major governmental funds</b>		<b>Total</b>
	<b>General fund</b>	<b>Debt service fund</b>	
Property taxes receivable	\$ 1,221,740	37,225	\$ 1,258,965

Property tax revenues recorded in the general fund and the debt service fund amounted to \$7,059,522 and \$339,046, respectively, for the fiscal year ended June 30, 2012.

**5. Sales and Use Taxes**

The Municipality imposes a sales and usage tax within the territorial limits of the Municipality pursuant to the Internal Revenue Code of the Government of Puerto Rico. This is a self-assessed tax consisting of one and a half percent (1.5%) on the sale price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item, as defined in the Puerto Rico Internal Revenue Code, as amended. The tax is assessed and collected on a monthly basis through a tax return filed by each business classified as tax withholding agent.

The sales and use tax revenues amounted to \$609,653 for the fiscal year ended June 30, 2012, which has been recorded in the general fund since is available for general operating purposes.

**6. Construction Excise Taxes**

The Municipality imposes and collects municipal construction excise taxes to most natural and legal persons and any governmental instrumentality that carry out activities related to construction, expansion, major repairs, relocations, alterations and other types of permanent improvements to residential, commercial and industrial buildings and structures within the territorial area of the Municipality. The tax is also applicable to infrastructure projects, the installation of machinery, equipment and fixtures, and other types of construction-related activities.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, project design and other engineering fees, licenses and permits, legal and accounting fees, and most marketing and advertising costs. The tax is paid by the taxpayer at the beginning of the project.

All single-family residential construction projects not related to housing development projects, condominiums, or any similar projects, are partially exempt from construction excise taxes. In addition, a portion of all single-family residential improvement projects are exempt from construction excise taxes. All projects carried out on buildings and structures classified as historical treasures by the Puerto Rico Planning Board have an in the tax rate applicable to construction excise taxes.

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Construction excise tax revenues amounted to \$188,938 for the fiscal year ended June 30, 2012, which has been recorded in the general fund since is available for general operating purposes.

**7. Intergovernmental Receivables and Payables**

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows at June 30, 2012:

	<u>Major governmental funds</u>				<u>Total</u>
	<u>General fund</u>	<u>Debt service fund</u>	<u>Community development block grant fund</u>	<u>Other governmental funds</u>	
<u>Intergovernmental receivables:</u>					
<i>Charges for services:</i>					
Solid waste disposal services to various municipalities, state government agencies and private entities	\$ 14,375	-	-	-	\$ 14,375
<i>Grants and contributions:</i>					
Puerto Rico Treasury Department - Employees' Christmas bonus cost reimbursement	65,252	-	-	-	65,252
Commonwealth of Puerto Rico - contribution of the state sales and use taxes	-	60,890	-	-	60,890
Puerto Rico Electric Power Authority - Contributions in lieu of municipal taxes	1,429,252	-	-	-	1,429,252
Puerto Rico Department of Education - Schools maintenance and capital improvements program	-	-	-	162,408	162,408
U.S. Department of Housing and Urban Development, through the Puerto Rico Office of the Commissioner of Municipal Affairs - SBGP Block Grant	-	-	48,964	-	48,964
Total intergovernmental receivables	<u>\$ 1,508,879</u>	<u>60,890</u>	<u>48,964</u>	<u>162,408</u>	<u>\$ 1,781,141</u>
<u>Intergovernmental payables:</u>					
<i>Utilities and charges for services:</i>					
Puerto Rico Electric Power Authority-Electric power consumption	\$ 1,429,252	-	-	-	\$ 1,429,252
Puerto Rico Treasury Department	173,328	-	-	-	173,328
Puerto Rico Water and Sewer Authority	56,794	-	-	-	56,794
Puerto Rico Labor and Human Resources Department	69,355	-	-	-	69,355
Total intergovernmental payables	<u>\$ 1,728,729</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>\$ 1,728,729</u>

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**8. Inter-fund Transactions**

The composition of all inter-fund balances at June 30, 2012 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	\$ 181,003
Capital improvements bond fund	26,208
Debt service fund	82
Other governmental funds	174,935
Total	\$ 382,228

	Transfers to:					
	General fund	Capital improvements bond fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	
<i>Transfers from:</i>						
<i>Major governmental funds:</i>						
General fund	\$ 264,784	141,313	25,619	879	2,452	\$ 435,047
Community development block grant fund					19,700	19,700
Other governmental funds	1,632	-	-	-	219,212	220,844
Total	\$ 266,416	141,313	25,619	879	241,364	\$ 675,591

The principal purposes of inter-fund receivables and payables are to recognize in the general fund the outstanding balance of loans receivable amounting to \$26,208 which were granted to the capital improvements bond fund to temporarily cover the cost of certain capital projects. In addition, inter-fund receivables include the outstanding balances of certain loans granted by the general fund 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 \$181,003 and \$174,935, respectively.

The principal purposes of inter-fund transfers are to recognize in the general fund certain non-routine cost reimbursements from the capital improvements amounting to \$141,313 and various intra-fund transfers amounting to \$264,784.

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, 2012.

At June 30, 2012, 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 have been reported at June 30, 2012 within due and advances from other funds and are not expected

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to be repaid within one year after year-end. Accordingly, at June 30, 2012, the general fund reported a reservation of fund balances (nonspendable fund balance) amounting to \$651,588 to properly disclose the portion of inter-fund receivables that are considered current available financial resources at June 30, 2012.

**9. Capital Assets**

Capital assets activity for the fiscal year ended June 30, 2012:

	<b>Balance at beginning of fiscal year</b>	<b>Additions/ depreciation expense</b>	<b>Balance at end of fiscal year</b>
<i>Governmental activities:</i>			
<i>Cost basis:</i>			
Capital assets, not being depreciated:			
Land	\$ 2,270,574	-	\$ 2,270,574
Construction in progress	5,137,706	3,721,086	8,858,792
Total capital assets not being depreciated/amortized	<u>7,408,280</u>	<u>3,721,086</u>	<u>11,129,366</u>
Capital assets, being depreciated:			
Land improvements	2,467,116	-	2,467,116
Buildings, structures, and improvements	12,493,230	88,785	12,582,015
Infrastructure	19,527,781	2,898,581	22,426,362
Machinery and equipment, and furniture and fixtures	1,783,424	169,214	1,952,638
Licensed vehicles	3,880,160	276,036	4,156,196
Total capital assets, being depreciated	<u>40,151,711</u>	<u>3,432,616</u>	<u>43,584,327</u>
Total cost basis of capital assets	<u>47,559,991</u>	<u>7,153,702</u>	<u>54,713,693</u>
<i>Accumulated depreciation:</i>			
Land improvements	1,523,363	64,298	1,587,661
Buildings, structures, and improvements	3,274,340	255,735	3,530,075
Infrastructure	8,042,628	778,880	8,821,508
Machinery and equipment, and furniture and fixtures	1,405,279	141,801	1,547,080
Licensed vehicles	3,569,411	271,715	3,841,126
Total accumulated depreciation	<u>17,815,021</u>	<u>1,512,429</u>	<u>19,327,450</u>
Net capital assets	<u>\$ 29,744,970</u>	<u>5,641,273</u>	<u>\$ 35,386,243</u>

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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, 2012:

General government	\$	331,876
Public safety		78,347
Public housing and welfare		91,850
Health and sanitation		73,596
Urban and economic development		733,912
Culture, recreation and education		202,848
Total depreciation and amortization expense	<u>\$</u>	<u>1,512,429</u>

**10. Deferred Revenues**

At June 30, 2012, deferred revenues recorded in the GWFS and the GFFS are as follows:

	Major governmental funds			Total governmental funds	Statement of net assets
	General fund	Legislative joint resolutions fund	Other governmental funds		
<i>Measurable and unavailable revenues:</i>					
Property taxes	\$ 67,708	-	-	67,708	\$ -
Total measurable and unavailable revenues	<u>67,708</u>	<u>-</u>	<u>-</u>	<u>67,708</u>	<u>-</u>
<i>Unearned revenues:</i>					
Municipal license taxes	529,890	-	-	529,890	148,395
Intergovernmental grants and contributions	-	3,091,173	1,825,951	4,917,124	4,917,124
Total unearned revenues	<u>529,890</u>	<u>3,091,173</u>	<u>1,825,951</u>	<u>5,447,014</u>	<u>5,065,519</u>
Total deferred revenues	<u>\$ 597,598</u>	<u>3,091,173</u>	<u>1,825,951</u>	<u>5,514,722</u>	<u>\$ 5,065,519</u>

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**11. Long-Term Obligations**

The general long-term debt activity for the fiscal year ended June 30, 2012 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	\$ 7,633,000	1,133,000	(385,000)	8,381,000	\$ 503,900
Obligations under capital leases	-	-	-	-	-
Compensated absences	1,597,345	57,299	-	1,654,644	896,955
Estimated liability for municipal solid waste landfill closure and post-closure care costs	9,580,973	1,809,513	-	11,390,486	-
Total long term obligations	<u>\$ 18,811,318</u>	<u>2,999,812</u>	<u>(385,000)</u>	<u>21,426,130</u>	<u>\$ 1,400,855</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 \$5.8 million at June 30, 2012, 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, 2012:

	<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, 2012) through July 1, 2019.	\$ 80,000
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, 2012) through July 1, 2019.	280,000
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 (4.73% at June 30, 2012) through July, 1, 2024.	550,000
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 (4.50% at June 30, 2012) through July 1, 2026.	740,000

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	<u>Outstanding amount</u>
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 (4.50% at June 30, 2012) through July 1, 2019.	875,000
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 (4.73% at June 30, 2012) through July 1, 2029.	200,000
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 (1.63% at June 30, 2012) through July 1, 2032.	2,760,000
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 (7.63% at June 30, 2012) through July 1, 2014.	100,000
2010 serial bonds for the acquisition of major capital assets, original amount of \$170,000, due in annual principal installments ranging from \$20,000 to \$35,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2012) through July 1, 2017.	150,000
2010 serial bonds for the acquisition of major capital assets, original amount of \$255,000, due in annual principal installments ranging from \$5,000 to \$20,000; plus interests due in semiannually installments at variable rates (5.00% at June 30, 2012) through July 1, 2035.	250,000
2010 serial bonds for the acquisition of major capital assets, original amount of \$188,000, due in annual principal installments ranging from \$20,000 to \$33,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2012) through July 1, 2017.	168,000

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	<u>Outstanding amount</u>
2010 serial bonds for the acquisition of major capital assets, original amount of \$1,110,000, due in annual principal installments ranging from \$15,000 to \$95,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2012) through July 1, 2035.	1,095,000
2011 serial bonds for the acquisition of major capital assets, original amount of \$325,000, due in annual principal installments ranging from \$5,000 to \$30,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2012) through July 1, 2036.	325,000
2011 serial bonds for the acquisition of major capital assets, original amount of \$325,000, due in annual principal installments ranging from \$45,900 to \$70,800; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2012) through July 1, 2016.	403,000
2011 serial bonds for the acquisition of major capital assets, original amount of \$325,000, due in annual principal installments ranging from \$45,000 to \$75,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2012) through July 1, 2018.	405,000
Total general obligation and public improvements bonds	<u>\$ 8,381,000</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.

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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>
2013	\$ 503,900	369,390	\$ 873,290
2014	454,300	520,526	974,826
2015	490,000	490,758	980,758
2016	486,000	458,955	944,955
2017	522,200	427,086	949,286
2018-2022	2,059,600	1,660,508	3,720,108
2023-2027	1,585,000	1,119,109	2,704,109
2028-2032	1,505,000	584,329	2,089,329
2033-2037	775,000	98,043	873,043
<b>Totals</b>	<b>\$ 8,381,000</b>	<b>5,728,704</b>	<b>\$ 14,109,704</b>

At June 30, 2012, accrued interest payable on bonds amounted to \$173,193. Interest expense paid on bonds amounted to \$317,649 for the fiscal year ended June 30, 2012.

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, 2012, 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.

## 12. 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 \$11,390,486 in the accompanying government-wide financial statements using current costs allocated based on the actual landfill capacity at June 30, 2012. The portion of the estimated current costs to be incurred in future years is approximately \$1.8 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, 2012 was recorded in the accompanying government-wide financial statements with a charge to health and sanitation expenses of \$1,809,513 in the statement of activities. The current costs of landfill closure and post-closure at June 30, 2012 is \$13.2 million.

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Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2012, the Municipality's landfill is still operating and its remaining estimated useful life is approximately five (5) years. Approximately 86 percent of the Municipality's total capacity has been used at June 30, 2012. However, the Municipality is currently evaluating alternatives for the expansion of its solid waste landfill. The expansion would extend the useful life for 9 years approximately.

The Municipality is required to demonstrate financial assurance for closure and post-closure care. However, at June 30, 2012, no assets or financial resources have been restricted to cover the future costs associated with closure costs and post-closure care.

### **13. 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:

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

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.

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- ***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***

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.

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- ***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 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.

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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.

- b) ***Funding Policy***

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

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2012

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, 2010, 2011 and 2012, 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:

<u>Fiscal year ended June 30,</u>	<u>Employer contributions</u>	<u>Employee contributions</u>
2010	\$ 281,638	\$ 247,798
2011	\$ 345,793	\$ 313,703
2012	\$ 346,976	\$ 307,712

The above actual employer contributions for the fiscal years ended June 30, 2010, 2011, and 2012 include the employer contributions to System 2000 amounting to \$32,840, \$26,678 and \$25,940, respectively. In addition, the above actual employee contributions for the fiscal years ended June 30, 2010, 2011, and 2012 include the employee contributions to System 2000 amounting to \$29,774, \$26,555 and \$22,995, 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 may be amended by law by the House of Representatives, the Senate and the Governor of the Commonwealth of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2012

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.

**14. 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, 2012. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be material to the basic financial statements taken as a whole, if any.

The Municipality has reported outstanding encumbrances amounting to \$651,588 in the general fund at June 30, 2012. 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, 2012, the Municipality has several outstanding or planned non-cancelable construction projects of which \$1.5 million have been already incurred and paid as of June 30, 2012 and \$0.5 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, 2012, 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 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.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Notes to Basic Financial Statements  
Fiscal Year Ended June 30, 2012

**15. Fund Balances, Net Assets and Prior-Period Adjustment**

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

	<u>General fund</u>	<u>Capital improvements bond fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	<u>Total</u>
<i><b>Nonspendable:</b></i>					
Long-term inter-fund loans	\$ 88,675	-	-	-	\$ 88,675
<i><b>Restricted for:</b></i>					
Debt service	-	-	2,153,109	-	2,153,109
Capital projects	-	2,262,589	-	483,686	2,746,275
Urban and economic development	-	-	-	26	26
Public safety	-	-	-	283	283
Public housing and welfare	-	-	-	184,966	184,966
Culture, recreation and education	-	-	-	468	468
<i><b>Assigned for:</b></i>					
Encumbrances:					
General government	651,588	-	-	-	651,588
<i><b>Unassigned</b></i>	5,933,352	-	-	-	5,933,352
Total fund balances	<u>\$ 6,673,615</u>	<u>2,262,589</u>	<u>2,153,109</u>	<u>669,429</u>	<u>\$11,758,742</u>

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Budgetary Comparison Schedule – General Fund  
 Fiscal Year Ended June 30, 2012

	Budgeted amounts		Actual amounts (budgetary basis-Note 1)	Variance with final budget- over (under)
	Original	Final		
<b>Revenues:</b>				
Taxes:				
Property taxes	\$ 7,005,337	7,005,337	7,005,337	\$ -
Municipal license taxes	480,000	801,427	806,500	5,073
Construction excise taxes	50,000	179,502	188,938	9,436
Sales and use taxes	350,000	510,725	609,654	98,929
Total tax revenues	7,885,337	8,496,991	8,610,429	113,438
Intergovernmental grants and contributions,	1,371,125	1,411,377	1,295,019	(116,358)
Interests on deposits	100,000	184,678	229,914	45,236
Charges for services	136,000	303,906	371,206	67,300
Miscellaneous revenues	102,500	240,037	256,005	15,968
Total revenues	9,594,962	10,636,988	10,762,573	125,585
<b>Expenditures:</b>				
Current:				
General government	4,482,693	5,376,638	4,692,687	(683,951)
Urban and economic development	1,147,611	1,497,595	1,253,889	(243,706)
Health and sanitation	1,358,067	1,530,064	1,380,623	(149,441)
Public safety	938,503	938,503	749,800	(188,703)
Public housing and welfare	771,082	873,682	737,342	(136,340)
Culture, recreation and education	499,098	574,598	422,457	(152,141)
Debt service:				
Principal	-	-	-	-
Interests	-	-	-	-
Capital outlays	397,908	397,908	397,908	-
Total expenditures	9,594,962	11,188,988	9,634,706	(1,554,282)
Revenues over (under) expenditures	-	(552,000)	1,127,867	1,679,867
<b>Other financing sources (uses):</b>				
Prior year's budgetary cash surplus readjustment	-	552,000	-	(552,000)
Transfers from other funds	-	-	435,047	435,047
Transfers to other funds	-	-	(266,416)	(266,416)
Total other financing sources, net	-	552,000	168,631	(383,369)
Revenues and other financing sources over expenditures and other financing uses	\$ -	-	1,296,498	\$ 1,296,498

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Schedule of Expenditures of Federal Awards  
June 30, 2012

	<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	\$ 897,911
Pass-through of the State-Office of the Department of the Family – Homeless Prevention and Rapid Rehousing Program	14.257 *	2011-000227	166,159
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>819,579</u>
Total U.S. Department of Housing and Urban Development			<u>1,883,649</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>112,172</u>
Total U.S. Department of Agriculture			<u>112,172</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>105,300</u>
Total U.S. Department of Energy			<u>105,300</u>
<b>U.S. Department of Homeland Security</b>			
Pass-through of the Governor's Office – Disaster Grants – Public Assistance	97.036	FEMA – 1919 FEMA - 4017	<u>293,650</u>
Total U.S. Department of Homeland Security			<u>293,650</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Schedule of Expenditures of Federal Awards  
June 30, 2012

**U.S. Department of Health and Human Services**

Pass-through of Puerto Rico Family Departement - Child Care Development Block Grant	93.575	241-2011-00016	<u>44,682</u>
Total U.S. Department of Health and Human Services			<u>44,682</u>
Total Federal Financial Assistance			<u>\$ 2,439,453</u>

\* American Recovery and Reinvestment Act Funds

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Notes to Schedule of Expenditures of Federal Awards  
June 30, 2012

**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	\$ 14,380,635
Nonmajor governmental funds	<u>3,670,049</u>
	18,050,684
Less: Non-federal expenditures	<u>(18,611,231)</u>
Total expenditures in the Schedule of Federal Awards	<u>\$ 2,439,453</u>



**Report on Internal Control over Financial Reporting and on Compliance and other matters  
Based on an audit of Financial Statements performed in accordance with  
Government Auditing Standards  
June 30, 2012**

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, 2012, which collectively comprise the Municipality's financial statements and have issued our report thereon dated November 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Municipality of Barranquitas of the Commonwealth of Puerto Rico is responsible for establishing and maintaining effective 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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses as item 12-01.

**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 item 12-02.

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 November 30, 2012.

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  
November 30, 2012

Stamp No. 2596748  
was affixed to the  
original report.

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

**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, 2012**

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

Compliance

We have audited the Municipality of Barranquitas of the Commonwealth of Puerto Rico (the Municipality) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have direct and material effect on each of the Municipality of Barranquitas of the Commonwealth of Puerto Rico major federal programs for the year ended June 30, 2012. 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 12-02 in the accompanying Schedule of Findings and Questioned Costs, the Municipality of Barranquitas of the Commonwealth of Puerto Rico, did not comply with requirements regarding cash management that are applicable to its Community Development Block Grant – State Program. Compliance with such requirement is necessary, in our opinion, for the Municipality, to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality of Barranquitas of the Commonwealth of Puerto Rico, complied, in all material respects, with the

compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

### Internal Control Over Compliance

Management of Municipality of Barranquitas of the 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 Municipality's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 12-01 to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 12-02 to be a significant deficiency.

Municipality's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Municipality's responses and, accordingly, we express no opinion on the responses.

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  
November 30, 2012

Stamp No. 2596749  
was affixed to the  
original report.

 CPA-PSC

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Schedule of Findings and Questioned Costs  
 June 30, 2012

**Financial Statements**

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

Noncompliance material to financial statements  
 noted?   X   yes        no

**Federal Awards**

Internal Control over major programs:  
 Material weakness (es) identified?   X   yes        no  
 Significant deficiency (ies) identified  
 not considered to be material weaknesses?        yes   X   none reported

Type of auditor's report issued on compliance  
 For major programs: Qualified

Any audit findings disclosed that are required  
 to be reported in accordance with  
 Circular A-133, Section .510(a)?   X   yes        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: \$300,000

Auditee qualified as low-risk auditee?        yes   X   no

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Schedule of Findings and Questioned Costs  
June 30, 2012

**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.

**12-01 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Schedule of Findings and Questioned Costs  
June 30, 2012

- No adequate year-end closing procedures are made to account for all transactions affecting all funds.
- 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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Schedule of Findings and Questioned Costs  
June 30, 2012

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 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, 2012 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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
Schedule of Findings and Questioned Costs  
June 30, 2012

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

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF BARRANQUITAS  
Schedule of Findings and Questioned Costs  
June 30, 2012

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

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
SBGP CFDA No. 14.228	<b>12-02 FEDERAL CASH MANAGEMENT SYSTEM</b>	

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 73 request of funds performed during the 2011-2012 fiscal year amounting to \$731,353, 48 (66%) disbursements amounting to \$663,652 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 should established procedures to minimize the time elapsing between drawdown's and disbursements.

Total questioned costs

\$        -

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2010-2011  
 June 30, 2012

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, 2011. 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 2011-2012).
- NR - Not resolved yet. Finding repeated in fiscal year 2011-2012.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
11-01	Deficiencies in the Uniform Accounting System and other Accounting Records	NR
11-02	Inadequate documentation of monitoring and fraud prevention activities	FR

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2010-2011  
 June 30, 2012

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, 2011. 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 2011-2012).
- NR - Not resolved yet. Finding repeated in fiscal year 2011-2012.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
11-03	Financial reporting	FR
11-04	Federal cash management system	NR

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2009-2010  
 June 30, 2012

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, 2010. 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 2011-2012).
- NR - Not resolved yet. Finding repeated in fiscal year 2011-2012.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
10-01	Deficiencies in the Uniform Accounting System and other Accounting Records	NR
10-02	Inactive and unnecessary funds	FR
10-03	Lack of monitoring and fraud prevention activities	FR
10-04	Deficiencies in accounting record of capital assets	FR

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF BARRANQUITAS**  
 Summary schedule of prior years audit findings  
 Fiscal Year 2009-2010  
 June 30, 2012

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, 2010. 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 2011-2012).
- NR - Not resolved yet. Finding repeated in fiscal year 2011-2012.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
10-05	Financial reporting	FR
10-06	Financial reporting	FR
10-07	Federal cash management system	NR