

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2011**

ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of Ciales
Ciales, 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 Ciales, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Colinas de Jaguas I Project, as of June 30, 2011. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Colinas de Jaguas I Project, is based on the report of the other auditors.

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 statement presentation. We believe that our audit provides a reasonable basis for our opinions.

Based on our report and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, discretely presented component unit, each major fund and the aggregate remaining fund information of the Municipality of Ciales as of June 30, 2011, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds for the fiscal 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 a report dated December 20, 2011 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 9, is not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Ciales' 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, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

San Juan, Puerto Rico
December 20, 2011

Ortiz, Rivera, Rivera & Co.

The stamp E18860 was affixed
to the original of this report.



MANAGEMENT'S DISCUSSION AND ANALYSIS

The Municipality of Ciales (the "Municipality") discussion and analysis has been designed with the followings goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget), and;
- e) Identify individual fund issues or concerns.

Since the Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality net assets decreased by \$388,591.
- Capital assets increased by \$908,314.
- Capital expenditures amounted to \$2,377,791.
- General fund deficit decreased by \$1,150,010.

USING THIS ANNUAL REPORT

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

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

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

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

Infrastructure Assets

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time. The Municipality has elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's net assets totaled \$10.668 million at the end of 2010, compared to \$11.357 million at the end of the previous year.

The largest portion of the Municipality's net assets consists of the investment made throughout the years in capital assets such as land, buildings, equipment and infrastructure. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although, the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represents another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and claims and judgments among others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations. The restricted portion consists of monies reserved for debt service and future capital expenditures.

Condensed Statement of Net Assets June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Current assets	\$ 4,857,423	\$ 3,940,155
Capital assets	<u>22,603,189</u>	<u>21,709,874</u>
Total assets	<u>27,460,612</u>	<u>25,650,029</u>
Current liabilities	5,228,218	6,036,345
Noncurrent liabilities	<u>11,551,873</u>	<u>8,553,537</u>
Total liabilities	<u>16,780,091</u>	<u>14,589,882</u>
Invested in capital assets, net of related debt	19,284,840	21,102,535
Restricted	2,197,850	673,885
Unrestricted	<u>(10,814,680)</u>	<u>(10,719,819)</u>
Total net assets	<u>\$ 10,668,010</u>	<u>\$ 11,056,601</u>

Changes in Net Assets

The Municipality's net assets decreased by \$388,591. Approximately 69 percent of the Municipality's total revenue came from grants and contributions, including federal aid, while 17 percent resulted from taxes. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works and public housing and welfare.

Condensed Statement of Activities

June 30, 2011 and 2010

	2011	2010
Program revenues		
Charges for services	\$ 1,854,686	\$ 1,074,801
Operating grants and contributions	1,568,155	1,068,616
Capital grants and contributions	1,024,899	613,865
General revenues		
Property taxes	1,923,674	1,632,553
Municipal license tax	428,404	420,041
Sales and use taxes	813,025	921,326
Grants and contributions not restricted to specific programs	5,497,229	5,497,423
Interest and investment earnings	1,193	4,241
Miscellaneous	610,991	2,256,136
Total revenues	<u>13,722,256</u>	<u>13,489,002</u>
Expenses		
General government	6,797,792	6,641,795
Public safety	1,069,026	884,970
Public housing and welfare	2,145,948	211,489
Public works	227,783	3,284,780
Economic development	2,160,039	1,961,984
Recreation	1,023,146	899,140
Interest on long-term debt	687,113	223,046
Total expenses	<u>14,110,847</u>	<u>14,107,204</u>
Change in net assets	(388,591)	(618,202)
Net assets, beginning of year	<u>11,056,601</u>	<u>11,674,803</u>
Net assets, end of year	<u>\$ 10,668,010</u>	<u>\$ 11,056,601</u>

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported a combined deficit of \$69,900 compared to a deficit of \$1,799,388 in the prior year.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2011, the general fund has a deficit of \$3,778,924. The deficit decreased by \$1,150,010 during fiscal year 2011.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget to reclassify certain expenditures among the different governmental functions. Such reclassifications were necessary to provide for the developments that affected the Municipality's finances.

The most significant variances between budget and actual results were a revenue shortfall on Intergovernmental revenue and lower than budgeted expenditures on public works.

The reason for the shortfall in Intergovernmental revenue is mainly related to the budgetary constraints faced by the Commonwealth of Puerto Rico which in turn is affecting the Municipality. Actual expenditures lower than budget is directly related to the shortfall in Intergovernmental revenue.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2011, amounts to \$35.5 million, net of accumulated depreciation of \$12.9 million, leaving a net book value of \$22.6 million. This investment in capital assets includes land, buildings, improvements, equipment, intangibles, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the Municipality's investment in capital assets for the current fiscal year was about 4.19% in terms of net book value. Actual expenditures to purchase or construct capital assets were \$2.4 million for the year. Depreciation charges for the year totaled \$1.5 million.

The Municipality finances a significant portion of its construction activities through bond issuances. 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. As of June 30, 2011, the Municipality has \$1.4 million of unexpended proceeds from grants that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a municipality to be able to issue additional general obligation bonds and notes such municipality must have sufficient "payment capacity." Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2011-2012 fiscal year.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 1st floor of the Town Hall, Ciales, Puerto Rico 00638.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
STATEMENT OF NET ASSETS
JUNE 30, 2011**

<u>Assets</u>	<u>Governmental Activities</u>	<u>Colinas de Jaguas</u>
Cash in bank (Notes 2 and 5)	\$ 127,416	\$ 700
Cash with fiscal agent (Notes 2 and 5)	2,434,179	
Accounts receivable:		
Property taxes	6,922	
Rent		9,808
Sales and use tax	62,188	
Due from other agencies (Note 9)	2,226,718	
Restricted deposits		138,659
Other assets		1,487
Capital assets, net (Note 11)	22,603,189	357,932
	\$ 27,460,612	\$ 508,586
<u>Liabilities and Net Assets</u>		
Liabilities		
Bank overdraft	\$ 12,511	\$ -
Accounts payable and accrued liabilities	788,296	49,173
Due to other agencies (Note 12)	2,944,296	
General obligations:		
Bonds	753,000	
Interest	187,797	
Deferred revenues (Note 13):		
Municipal license tax	241,423	
Accrued interest	313,406	
Noncurrent liabilities (Note 15):		
Due within one year	753,308	26,559
Due in more than one year	10,798,565	1,475,858
Total liabilities	16,792,602	1,551,590
Net Assets		
Investment in capital assets, net of related debt	20,491,932	
Restricted for:		
Debt service	763,755	
Capital project	1,434,095	
Unrestricted	(12,021,772)	(1,043,004)
Total net assets	10,668,010	(1,043,004)
	\$ 27,460,612	\$ 508,586

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Functions/Programs</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>		
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Primary Governmental Activities</u>	<u>Component Unit Colinas de Jaguas Project</u>
Primary Government:						
General government	\$ 6,797,792	\$ 1,854,686	\$ -	\$ -	\$ (4,943,106)	\$ -
Public safety	1,069,026				(1,069,026)	
Public housing and welfare	2,145,948				(2,145,948)	
Recreation	1,023,146				(1,023,146)	
Economic development	2,160,039				(2,160,039)	
Public work	227,783		1,568,155	1,024,899	2,365,271	
Interest on long-term debt	687,113				(687,113)	
Total primary government	<u>\$ 14,110,847</u>	<u>\$ 1,854,686</u>	<u>\$ 1,568,155</u>	<u>\$ 1,024,899</u>	<u>(9,663,107)</u>	<u>-</u>
Component Unit:						
Colinas de Jaguas Project	\$ 386,941	\$ 340,011	\$ -	\$ -		(46,930)
General revenues:						
Property taxes (Note 6)					1,923,674	
Municipal license tax (Note 7)					428,404	
Sales and use taxes (Note 8)					813,025	
Grants and contributions not restricted to specific programs					5,497,229	
Interest, fines and penalties					1,193	
Miscellaneous					610,991	
Total general revenues					<u>9,274,516</u>	<u>-</u>
Change in net assets					(388,591)	(46,930)
Net assets at beginning of year					11,056,601	(996,074)
Net assets at end of year					<u>\$ 10,668,010</u>	<u>\$ (1,043,004)</u>

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2011

<u>Assets</u>	General	Joint Resolution	Debt Service	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents (Notes 2 and 5)	\$ 62,055	\$ 95	\$ -	\$ 65,266	\$ 127,416
Cash with fiscal agent (Notes 2 and 5)	6,844		1,654,793	772,542	2,434,179
Accounts receivable:					
Sales taxes	19,351		42,837		62,188
Property taxes			6,922		6,922
Rent, licenses, and permits					-
Due from other agencies (Note 9)	1,914,448			312,270	2,226,718
Due from other funds (Note 10)	127,412	1,434,000		643,058	2,204,470
Total assets	<u>\$ 2,130,110</u>	<u>\$ 1,434,095</u>	<u>\$ 1,704,552</u>	<u>\$ 1,793,136</u>	<u>\$ 7,061,893</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2011**

<u>Liabilities and Fund Balance (Deficit)</u>	<u>General</u>	<u>Joint Resolution</u>	<u>Debt Service</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities					
Bank overdraft	\$ 12,511	\$ -	\$ -	\$ -	\$ 12,511
Accounts payable and accrued liabilities	644,746			143,550	788,296
Due to other funds (Note 10)	2,066,058			138,412	2,204,470
Due to other agencies (Note 12)	2,944,296				2,944,296
General obligations:					
Bonds			753,000		753,000
Interest			187,797		187,797
Deferred revenues: (Note 13)					
Municipal license tax	241,423				241,423
Total liabilities	<u>5,909,034</u>	<u>-</u>	<u>940,797</u>	<u>281,962</u>	<u>7,131,793</u>
Fund Balance (Deficit)					
Nonspendable					
Restricted	758,329	1,434,095	763,755	907,625	3,863,804
Committed	81,466			603,549	685,015
Assigned	728,308				728,308
Unassigned	(5,347,027)				(5,347,027)
Total fund balances (deficit)	<u>(3,778,924)</u>	<u>1,434,095</u>	<u>763,755</u>	<u>1,511,174</u>	<u>(69,900)</u>
Total liabilities and fund balances	<u>\$ 2,130,110</u>	<u>\$ 1,434,095</u>	<u>\$ 1,704,552</u>	<u>\$ 1,793,136</u>	<u>\$ 7,061,893</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2011**

Total fund balances - governmental funds \$ (69,900)

Amounts reported for governmental activities in the statement of net assets are different because:

- Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet 22,603,189

- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. **(Note 4)** (11,865,279)

Net assets of governmental activities \$ 10,668,010

The accompanying notes are an integral part of these basic financial statements.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

	General	Joint Resolution	Debt Service	Other Governmental Funds	Total Governmental Funds
REVENUES					
Property taxes (Note 6)	\$ 1,310,670	\$ -	\$ 613,004	\$ -	\$ 1,923,674
Municipal license taxes (Note 7)	428,404				428,404
Sales and use taxes (Note 8)	236,876		576,149		813,025
Licenses, permits, and other local taxes	1,346,233				1,346,233
Charges for services	508,453				508,453
Intergovernmental revenues (Note 14):					
Federal grants and contributions		210,000		2,593,054	2,593,054
State contributions	5,287,229				5,497,229
Interest, fines, and penalties	-		1,193		1,193
Other revenues	610,991				610,991
Total revenues	<u>9,728,856</u>	<u>210,000</u>	<u>1,190,346</u>	<u>2,593,054</u>	<u>13,722,256</u>
EXPENDITURES					
Current:					
General government	6,160,324				6,160,324
Public safety	773,337				996,335
Public housing and welfare	926,585			222,998	2,056,473
Economic development		43,257		184,526	227,783
Public works	2,085,532				2,085,532
Culture and education	422,046				422,046
Capital outlays	1,230,015			1,147,777	2,377,792
Debt service:					
Principal			1,472,777		1,472,777
Interest			373,706		373,706
Total expenditures	<u>11,597,839</u>	<u>43,257</u>	<u>1,846,483</u>	<u>2,685,189</u>	<u>16,172,768</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,868,983)</u>	<u>166,743</u>	<u>(656,137)</u>	<u>(92,135)</u>	<u>(2,450,512)</u>
OTHER FINANCING SOURCES (USES)					
Loan proceeds	3,765,000				4,180,000
Transfers in	466		746,473	415,000	746,939
Transfers out	(746,473)		(466)		(746,939)
Total other financing sources	<u>3,018,993</u>	<u>-</u>	<u>746,007</u>	<u>415,000</u>	<u>4,180,000</u>
Excess of revenues over expenditures and other financing sources (uses)	<u>1,150,010</u>	<u>166,743</u>	<u>89,870</u>	<u>322,865</u>	<u>1,729,488</u>
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR	<u>(4,928,934)</u>	<u>1,267,352</u>	<u>673,885</u>	<u>1,188,309</u>	<u>(1,799,388)</u>
FUND BALANCE (DEFICIT) AT END OF YEAR	<u>\$ (3,778,924)</u>	<u>\$ 1,434,095</u>	<u>\$ 763,755</u>	<u>\$ 1,511,174</u>	<u>\$ (69,900)</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Net change in fund balances - total governmental funds \$ 1,729,488

Amounts reported for governmental activities in the statement of activities are different because:

- Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. 2,377,792
- Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental (1,484,477)
- Governmental funds report issuance of long-term debt as other financial sources because provides current financial resources. (4,180,000)
- Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 1,472,777
- Change in accrued interest expense which does not require the use of current financial resources. (313,406)
- Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in 9,235

Changes in net assets of governmental activities \$ (388,591)

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
STATEMENT OF REVENUES AND EXPENDITURES, BUDGET AND ACTUAL - GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	General Fund				Debt Service Fund				Variance with Final Budget- Positive (Negative)
	Budgeted Amounts		Actual	Budgeted Amounts		Final	Actual	Final	
	Original	Final		Original	Final				
REVENUES									
Property taxes	\$ 1,276,872	\$ 1,276,872	\$ 1,146,029	\$ (130,843)	\$ 367,056	\$ 410,578	\$ 613,004	\$ 202,426	
Municipal license taxes	427,476	427,476	428,403	927					
Sales and use taxes	1,233,972	1,233,972	239,979	(993,993)					
Licenses and permits	647,376	647,376	1,346,233	698,857			576,149	576,149	
Charges for services	588,288	588,288	578,353	(9,935)					
Intergovernmental revenues:									
State contributions	6,311,160	6,311,160	5,329,650	(981,510)			1,193	1,193	
Interest, fines, and penalties	46,500	46,500	308	(46,192)					
Other revenues	900,012	900,012	83,666	(816,346)					
Total revenues	11,431,656	11,431,656	9,152,621	(2,279,035)	367,056	410,578	1,190,346	779,768	
EXPENDITURES									
Current:									
General government	5,033,508	5,171,851	4,162,636	1,009,215					
Public safety	1,008,504	913,702	773,337	140,365					
Public works	3,930,252	3,880,311	2,033,226	1,847,085					
Recreation	483,264	467,164	422,047	45,117					
Health and welfare	976,128	978,128	926,585	51,543					
Transfers to other funds		20,500	20,500	-	367,056	410,578	1,846,483	(1,435,905)	
Total expenditures	11,431,656	11,431,656	8,338,331	3,093,325	367,056	410,578	1,846,483	(1,435,905)	
Excess (deficiency) of (expenditures) revenues over revenues (expenditures)	\$ -	\$ -	\$ 814,290	\$ 814,290	\$ -	\$ -	\$ (656,137)	\$ (656,137)	

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

1. ORGANIZATION

The Municipality of Ciales, Puerto Rico (Municipality) was founded in 1815. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of the municipal character, with perpetual succession existence and legal personality, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, culture and recreation as well as many other general and administrative services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 12 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

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

- Management's Discussion and Analysis - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- Government - Wide Financial Statements - The reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).
- Statement of Net Assets - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.

- **Statement of Program Activities** - The government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- **Budgetary comparison schedules** - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

A reporting entity is comprised of the primary government, component units and other organizations that are included to ensure that financial statements are not misleading. The primary government consists of all funds, departments, boards and agencies that are not legally separate from the Municipality and for which the Municipality is financial accountable.

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 Municipality is not financially accountable but 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 accompanying basic financial statements to be misleading or incomplete. Accordingly, a legally separate organization would be reported as a component unity of the Municipality if all of the following criteria are met:

- 1) The Mayor appoints a voting majority of an organization's governing body and, either (1) the Municipality has the ability to impose its will on that organization or (2) the organization has the potential to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

- 2) The economic resources, for which the Municipality is entitled, either received or held by the separate organization, are entirely or almost entirely for the direct benefit of the Municipality or its constituents.

GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions.

The Municipality's management has concluded that, based on the aforementioned criteria, the Colinas de Jaguas Project is a legally separate entity that should be reported as component unit of the Municipality for the fiscal year ended June 30, 2011.

The Colinas de Jaguas Project is included in the basic financial statements as a discretely component unit because of the nature of the services they provide and the Municipality's ability to impose its will.

Colinas de Jaguas Project is a 54-unit multi-family housing project owned by the Municipality as authorized transfer from the Special Trustee for the Liquidation of the Accounts of the Puerto Rico Urban Renewal and Housing Corporation. The Project is operated under Section 515 of USDA, Rural Development (USDA-RD) and regulated by the U. S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods. The project is also subject to Section 8 Housing Assistance Payments agreements with HUD, and a significant portion of the Project's rental income is received from HUD. Also, the Project is financed by a Mortgage of Section 515 Direct Loan.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

For the fiscal year ended June 30, 2011, the Municipality implemented Government Accounting Standards Board Statement No. 54 (GASB 54), "Fund Balance Reporting and Governmental Fund Type Definitions". The requirements of this statement are effective for financial statement periods beginning after June 15, 2011.

GASB 54 enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied, and it clarifies the existing governmental fund type definitions. It establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

GASB 54 also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements. The definitions of the General fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are also clarified by the provisions in this statement.

c. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under an accrual accounting.

However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

2) Joint Resolution Fund

This fund is used to account the resources for all the transactions of the State Contribution by Legislature Resolutions. The primary objective of these funds is the development of projects on communities, non-for-profit organizations,

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

purchase of equipment and indirect assignment to persons of low and moderate income.

3) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, licenses, permits, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the other governmental fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. Interfund Receivables and Payables

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

f. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure (which is normally immovable and of value only to the Municipality, such as roads, bridges, streets' sidewalks, and drainage system), are reported in the applicable governmental or component units columns in the government-wide financial statements.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipments	5-20 years

g. Fund Balances

In the current year, the Municipality adopted the provisions of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (GASB No. 54), which enhanced the usefulness of fund balance information by providing

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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 No. 54, the accompanying fund financial statements report fund balance amounts that are considered nonspendable, such as fund balance associated with inventories. Other fund balances have been reported as restricted, committed, assigned, and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- 1) *Nonspendable* - Represent resources that cannot be spent readily with cash or are legally or contractually required not be spent, including but not limited to inventories, prepaid items, and long term balances of interfund loans and accounts receivable.
- 2) *Restricted* - Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
- 3) *Committed* - Represent resources used for specific purposes, imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.
- 4) *Assigned* - Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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

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

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2011.

In situations when 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 projects fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB No. 54. In addition, the financial positions and the results of operations reported in the accompanying fund financial statements as of and for the fiscal year ended June 30, 2011 have not been affected for this change in accounting principle. Accordingly, the accompanying fund financial statements have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2010.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2011 amounted to approximately \$245,048. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$208,143 for workers' compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

j. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

k. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

Statement Number	Statement Name	Adoption Required in Fiscal Year
57	OPEB Measurement by Agent Employees and Agent Multi-Employers Plans	2011-12
60	Accounting and Financial Reporting for Service Concession Arrangements	2012-13
61	The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and 34	2012-13
62	Codification of Accounting and Financial Reporting Guidance Contained in Pre - November 30, 1989 FASB and AICPA Pronouncements	2012-13
63	Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position	2012-13
64	Derivative Instruments: Application of Hedge Accounting Termination Provisions - an Amendment of GASB Statement No. 53	2011-12

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

3. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

a. Budgetary Control

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

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, include only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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

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

The annual budget is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2011 representing the original budget.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing use for the year ended June 30, 2011 is presented below for the general and debt service funds:

Debt Service

Excess of expenditures over revenues - budgetary basis	(\$656,137)
Entity differences:	
Non-budgeted transfers	<u>746,007</u>
Excess of expenditures over revenues - GAAP basis	<u>\$ 89,870</u>

Explanation of differences:

	<u>General Fund</u>
Sources/inflows of resources	
Actual amounts (budgetary basis) "available appropriation" from the budgetary comparison schedule	\$ 9,152,621
Differences - budget to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(466)
Transfers from other funds are inflow of budgetary sources but are not revenues for financial reporting purposes	<u>576,701</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances	<u>\$ 9,728,856</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Uses/outflows of resources

Actual amounts (budgetary basis) "total charges to Appropriations" from the budgetary comparison schedule	\$ 8,338,331
Differences-budget to GAAP:	
Prior year encumbrances recorded as current year expenditures for GAAP basis	5,024
Current year encumbrances recorded as expenditures for budgetary purposes	(728,308)
Transfers to other funds are out flow of budgetary uses but are not expenditures for financial reporting purposes	<u>3,982,792</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances	<u>\$11,597,839</u>

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$11.9 million differences are as follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Bonds payable	\$ 2,944,000
Compensated absences	1,240,508
Notes payable	6,540,360
Accrued interest	313,406
Claims and judgments	183,000
Other long-term liabilities	<u>644,005</u>
Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	<u>\$11,865,279</u>

5. DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The deposits at GDB of approximately \$772,542 that is restricted principally for capital projects and the \$1,654,793 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its investments in one (1) bank located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC). The standard insurance amount limit is \$250,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by

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May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.33% for real property and 10.33% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	4.00%	6.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	3.50%	3.50%
Discounts made by state to tax payer	< .20% >	< .20% >
	<u>8.33%</u>	<u>10.33%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax – municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax – state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

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Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year ends. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. During July 2002, the Municipality entered into a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001 for approximately \$1.1 million. This amount will be repaid through advances from property taxes (refer to Note 15).

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2010-11, but not the final settlement as the six months period after fiscal year ends, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2011, the amount received by CRIM, less than the amount collected from taxpayers and charges by CRIM received by the Municipality for the same period by approximately \$20,562. Such amount is presented as intergovernmental receivable in the general fund in the basic financial statements (refer to Note 9).

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2011. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations that have operations in the Municipality of Ciales, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

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An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of Ciales are as follows:

Savings and loans associations	=	1.00%
Financial institutions	=	1.50%
Other organizations:	=	.50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$241,423, corresponding to the next fiscal year municipal license.

8. SALES AND USE TAXES

On July 29, 2007 the Commonwealth Legislature approved Act No. 80 ("Act 80") which imposed to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1% of the 1.5% will be collected by the Municipalities and the remaining .5% of the 1.5% will be collected by the Puerto Rico Department of Treasury.

Act 80 also provides for restrictions on the use of the resources (including the .5 of 1.5% collected by the Commonwealth Government) to be invested in solid waste and recycling programs, capital improvements and health and public safety costs. Amount collected by the Commonwealth Government will be deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

- a. .2% of the .5% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the Act,
- b. .2% of the .5% will be deposited in a "Municipal Redemption Fund" to finance loans to municipalities subject to restrictions imposed by the Act and,
- c. .1% of the .5% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

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9. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power Authority (General Fund)	\$ 1,828,713
Labor Department (General Fund)	54,673
CRIM (General Fund)	20,562
Education Department - (General Fund)	10,500
OCAM - SBGP Program (Other Governmental Fund)	127,456
Department of Energy - EECBG Program (Other Governmental Fund)	95,250
Family Department - HPRP Program (Other Governmental Fund)	35,668
Family Department - Child Care Program (Other Governmental Fund)	35,000
Education Department - Even Start Program (Other Governmental Fund)	<u>18,896</u>
 Total	 <u><u>\$2,226,718</u></u>

10. INTERFUND TRANSACTIONS

a. Due From/To Other Funds:

The due from and due to other fund balances as of June 30, 2011, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other Governmental Funds	\$ 127,412
Joint Resolution Fund	General Fund	1,434,000
Joint Resolution Fund	Other Governmental Funds	576,058
Other Governmental Funds	Other Governmental Funds	<u>67,000</u>
		<u><u>\$2,204,470</u></u>

The balance of \$1,434,000 due from the general fund to the Joint Resolution Fund represents amount due from prior years related to state contributions' grants.

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Remaining transfers are used to use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2011 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Debt Service	General	\$ 746,473
General Fund	Debt Service	<u>466</u>
		<u>\$ 746,939</u>

The transfers are used to (1) move revenues from the fund that statute or budget revenues to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the fund collection the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

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11. CAPITAL ASSETS

Capital asset activity for the Municipality for the year ended June 30, 2011 was as follows:

Description	Balance July 1, 2010	Increases	Decreases	Balance June 30, 2011
CAPITAL ASSETS, NOT BEING DEPRECIATED				
Land	\$ 1,706,856	\$ -	\$ -	\$ 1,706,856
Construction in progress	334,453	517,803	405,503	446,753
Total capital assets, not being depreciated	<u>2,041,309</u>	<u>517,803</u>	<u>405,503</u>	<u>2,153,609</u>
CAPITAL ASSETS, BEING DEPRECIATED				
Land improvements	7,774,125	1,357,115		9,131,240
Buildings and building improvements	5,378,957	96,122		5,475,079
Furniture and fixtures	882,629	175,430		1,058,059
Vehicles and equipment	2,830,223	152,193		2,982,416
Works of Art	75,000	76,050		151,050
Infrastructure	14,167,983	408,582		14,576,565
Total capital assets, being depreciated	<u>31,108,917</u>	<u>2,265,492</u>	<u>-</u>	<u>33,374,409</u>
LESS ACCUMULATED DEPRECIATION FOR:				
Land improvements	1,848,463	588,774		2,437,237
Buildings and building improvements	2,258,705	186,265		2,444,970
Furnitures and fixtures	613,148	143,992		757,140
Vehicles and equipment	2,529,679	170,822		2,700,501
Works of Art	45,000	30,210		75,210
Infrastructure	4,145,357	364,414		4,509,771
TOTAL ACCUMULATED DEPRECIATION	<u>11,440,352</u>	<u>1,484,477</u>	<u>-</u>	<u>12,924,829</u>
TOTAL CAPITAL ASSETS, BEING DEPRECIATED, NET	<u>19,668,565</u>	<u>781,015</u>	<u>-</u>	<u>20,449,580</u>
GOVERNMENTAL ACTIVITIES CAPITAL ASSETS, NET	<u>\$ 21,709,874</u>	<u>\$ 1,298,818</u>	<u>\$ 405,503</u>	<u>\$ 22,603,189</u>

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

General government	\$ 646,704
Culture and education	601,100
Public works	72,691
Health and sanitation	89,475
Public works	<u>74,507</u>

Total depreciation expense - governmental activities \$ 1,484,477

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Capital asset activity for Colinas de Jaguas Project, a discretely presented component unit, for the year ended June 30, 2011 was as follows:

<u>Component Unit - Colinas de Jaguas Project</u>	<u>Balance July 1, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2011</u>
Capital assets, not being depreciated:				
Land	\$ 154,124	\$ -	\$ -	\$ 154,124
Total capital assets, not being depreciated	<u>154,124</u>	<u>-</u>	<u>-</u>	<u>154,124</u>
Capital assets, being depreciated:				
Buildings, equipment, and furniture	2,303,319	46,574		2,349,893
Total capital assets, being depreciated	<u>2,303,319</u>	<u>46,574</u>	<u>-</u>	<u>2,349,893</u>
Less accumulated depreciation for:				
Buildings, equipment, and furniture	2,050,159	95,926		2,146,085
Total accumulated depreciation	<u>2,050,159</u>	<u>95,926</u>	<u>-</u>	<u>2,146,085</u>
Total capital assets, being depreciated, net	<u>253,160</u>	<u>(49,352)</u>	<u>-</u>	<u>203,808</u>
Colinas de Jaguas Project capital assets, net	<u>\$ 407,284</u>	<u>\$ (49,352)</u>	<u>\$ -</u>	<u>\$ 357,932</u>

12. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2011 are as follows:

Puerto Rico Electric Power Authority	\$ 1,830,235
Puerto Rico Retirement System Administration	451,776
Internal Revenue Service	389,469
Puerto Rico Water and Sewer Authority	124,345
Treasury Department	120,162
Puerto Rico General Services Administration	16,004
Labor Department	<u>12,305</u>
Total	<u>\$ 2,944,296</u>

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13. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of approximately \$241,423 in the general fund related to municipal license tax collected in fiscal year 2010-11 that will be earned in fiscal year 2011-12.

b. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant.

14. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

15. LONG-TERM DEBTS

Bonds and other long-term liabilities outstanding at June 30, 2011 are as follows:

Bonds

\$181,000 series of 1992, payable in annual installments of \$14,000 to \$13,000 until January 1, 2017, interest at 5%.	\$ 68,000
\$400,000 series of 1996, payable in annual installments of \$10,000 to \$40,000 until July 1, 2016, interest from 5% to 8%.	155,000
\$250,000 series of 2004, payable in annual installments of \$5,000 to \$25,000 until July 1, 2028, interest from 5% to 7%.	210,000
\$282,000 series of 2007, payable in annual installments of \$35,000 to \$45,000 until January 1, 2014, interest at 4.25%.	131,000

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\$300,000 series of 2007, payable in annual installments of \$35,000 to \$55,000 until July 1, 2013, interest from 6.6% to 7.5%.	\$ 105,000
\$1,555,000 series of 2010, payable in annual installments of \$20,000 to \$175,000 until July 1, 2024, interest from 4.75% to 7.5%.	1,520,000
\$755,000 series of 2010, payable in annual installments of \$15,000 to \$130,000 until July 1, 2019, interest from 5% to 7.5%.	700,000
\$415,000 series of 2011, payable in annual installments of \$5,000 to \$10,000 until July 1, 2017, interest from 5% to 7.5%.	<u>55,000</u>
Total bonds payable	<u>\$ 2,944,000</u>

Notes Payable

Note payable of \$1,174,924 represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate principal installments of \$15,373 plus interest rate of 6.1875%.	\$1,010,560
Note payable of \$340,000, series 2005, its payable in annual installments of \$25,000 to \$40,000 until July 2014, interest from 4.37% to 7.25%.	120,000
Note payable of \$49,600, series 2006, its payable in annual installments of \$6,100 to \$8,100 until January 1, 2013, interest at 4.5%.	15,800
Note payable of \$500,000, series 2009, its payable in annual installments of \$100,000 until July 1, 2013, interest at 5%.	275,000

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Note payable of \$1,210,000, series 2009, its payable in annual installments of \$10,000 to \$140,000 until July 1, 2021, interest at 5%.	\$ 1,065,000
Note payable of \$523,000, series 2009, its payable in annual installments of \$51,000 to \$82,000 until July 1, 2016, interest from 2.42% to 7.5%.	359,000
Note payable of \$3,765,000, series 2010, its payable in annual installments of \$80,000 to \$330,000 until July 1, 2027, interest from 6.0% to 7.5%.	<u>3,695,000</u>
Total notes payable	<u>\$ 6,540,360</u>

Other Long-Term Liabilities

Due to Labor Department, payable in monthly installments of \$4,599 until February 1, 2012.	\$ 91,987
Due to CRIM corresponding to LIMS System, payable in monthly installments of \$1,411 until November 2011, interest at 5.95%.	8,220
Due to CRIM corresponding to Law 46, payable in monthly installments of \$1,814 until March 2032, interest at 6.22%.	183,380
Due to Puerto Rico Health Insurance Administration	<u>360,418</u>
Total other long-term liabilities	<u>\$ 644,005</u>

Component Unit

The original mortgage, in the amount of \$1,945,000 was payable to Rural Housing Service (RHS) and collateralized by the apartment complex. The required monthly principal and interest payments totaled \$11,053. On November 14, 1997, the mortgages on the property were transferred from the Puerto Rico Urban and Housing Corporation to the new owner, the Municipality of Ciales. Rural Housing

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Service, the mortgagee, recalculated and adjusted the amortization of the mortgages at the time, resulting in a smaller monthly payment. The revised payments of the three mortgages commenced on December 1, 1997.

Under agreements with RHS, the project is required to make monthly escrow deposits for insurance and replacement of Project assets, and is subject to restrictions as to operating policies, rental charges and operating expenditures.

The liability of the Project under the mortgages is limited to the underlying value of the real estate, plus other amounts deposited with the lender.

The mortgages are insured by RHS, collateralized by the Project, and consist of the following:

Interest at 6.5%, payable in monthly installments of \$8,159, including interest, through the due date, December 2031.	\$1,169,181
Interest at 8.75%, payable in monthly installments of \$2,351, including interest, through the due date, December 2031.	278,989
Interest at 11.25%, payable in monthly installments of \$543, including interest, through the due date, December 2032.	<u>54,247</u>
Less current maturities	<u>1,502,417</u> <u>26,559</u>
	<u>\$1,475,858</u>

The interest rates shown above are net of 2% interest rental credit.

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Aggregate maturities of the mortgage payable for each of the next five years following June 30, 2011 and thereafter, are as follows:

<u>Year Ended June 30,</u>	<u>Amount</u>
2012	\$ 26,559
2013	29,031
2014	34,695
2015	37,935
2016 and thereafter	<u>1,374,197</u>
	<u>\$1,502,417</u>

The annual debt service requirements for the bonds payable and notes payable at June 30, 2011, are as follows:

	<u>Bonds</u>		<u>Notes Payable</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 197,000	\$ 172,294	\$ 359,164	\$ 141,112
2013	239,000	195,358	376,101	156,431
2014	206,000	180,013	393,635	140,260
2015	261,000	167,200	281,371	123,249
2016	283,000	148,800	953,216	115,403
2017-2021	1,133,000	455,904	1,693,087	432,886
2022-2026	585,000	102,752	1,725,083	188,515
2027-2031	40,000	3,900	675,944	87,154
2032-2036			82,759	3,860
	<u>\$2,944,000</u>	<u>\$1,426,221</u>	<u>\$6,540,360</u>	<u>\$1,388,870</u>

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Long-term liabilities activity for the year ended June 30, 2011 was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
Governmental Activities:					
Bonds payable	\$ 3,063,000	\$ 415,000	\$ 534,000	\$ 2,944,000	\$ 197,000
Notes payable	3,103,777	3,765,000	328,417	6,540,360	359,164
Total long-term debt	6,166,777	4,180,000	862,417	9,484,360	556,164
Other long-term liabilities:					
Puerto Rico Retirement System					
Administration	134,211		134,211	-	
Labor Department	91,987			91,987	55,192
Due to Treasury Department					
Loan \$500,000	451,684		451,684	-	
LIMS System	23,952		15,732	8,220	8,220
CRIM Law 46	192,112		8,732	183,380	8,732
ASES	300,348	60,070		360,418	
Claims and judgements	183,000			183,000	
Compensated absences	1,309,814		69,306	1,240,508	125,000
Total other long-term liabilities	2,687,108	60,070	679,665	2,067,513	197,144
Total noncurrent liabilities, governmental activities	\$ 8,853,885	\$ 4,240,070	\$ 1,542,082	\$ 11,551,873	\$ 753,308
Component Unit:					
Colinas de Jaguas Project mortgage payable	\$ 1,526,726	\$ -	\$ 24,309	\$ 1,502,417	\$ 26,559

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16. FUND BALANCES

As of June 30, 2011, fund balances is comprised of the following:

	<u>General</u>	<u>Joint Resolution</u>	<u>Debt Service</u>	<u>Other Government al Funds</u>	<u>Total</u>
Restricted:					
Debt service	\$ -	\$ -	\$ 763,755	\$ -	\$ 763,755
General government	17,681			308	17,989
Health and welfare				112,473	112,473
Public safety				1,713	1,713
Capital outlays	740,648	1,434,095		793,131	2,967,874
Committed:					
Public works	81,466			603,549	685,015
Assigned:					
General government	606,809				606,809
Public safety	2,676				2,676
Public works	108,807				108,807
Culture	9,926				9,926
Health and welfare	90				90
Unassigned	(5,347,027)				(5,347,027)
	<u>\$ (3,778,924)</u>	<u>\$ 1,434,095</u>	<u>\$ 763,755</u>	<u>\$ 1,511,174</u>	<u>\$ (69,900)</u>

17. FUND BALANCE DEFICIT

The following fund had a deficit in fund balance at June 30, 2011:

<u>Fund</u>	<u>Deficit</u>
General	<u>\$3,778,924</u>

The deficit of the General fund will be covered by future budgetary appropriations.

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18. NET ASSETS

Net assets invested in capital assets, net of related debt is comprised of the following:

Capital assets, net of accumulated depreciation.	\$ 22,603,189
Outstanding balance on capital related debt	(2,714,800)
Unspent capital debt proceeds	<u>603,543</u>
 Total invested in capital assets, net of related debt	 <u>\$ 20,491,932</u>

19. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the ACT 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

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The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 2000 will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2011 was approximately \$561,962. The Municipality's payroll for employees covered by ERS was approximately \$6.1 million. The Municipality total payroll for all employees was approximately \$5.5 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2011, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

17. RISK MANAGEMENT

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

18. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place under operating lease agreements with terms ranging from one to five years.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

- b. Total income from leases during the year ended June 30, 2011 was approximately \$76,157.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets. Leasing arrangements with the Municipality

The Municipality is obligated under no cancellable operational leases, with periods not longer than one year.

19. CONTINGENCIES

The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.

20. COMMITMENTS

The Municipality of Ciales had several outstanding or planned construction projects as of June 30, 2011. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Bonds Issuance Fund that amounted to approximately \$772,542.

21. SUBSEQUENT EVENTS

In preparing these financial statements, the Municipality has evaluated events and transactions for potential recognition or disclosure through December 20, 2011, the date the financial statements were issued.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Housing and Urban Development (HUD)		
Section 8 Housing Choice Vouchers	14.871	\$ 291,044
Pass-through Commissioner Office of Municipal Affairs (OCAM):		
State Block Grant Program - SBGP	14.228	1,031,175
Pass-through Municipality of San Juan:		
Hopwa	14.241	6,238
Pass-through Department of Family:		
Homelessness Prevention and Rapid Re-Housing Program (HPRP) (Recovery Act Funded)	14.257	120,219
Subtotal U.S. Department of Housing and Urban Development		<u>1,448,676</u>
U.S. Department of Energy		
Pass-through commonwealth of Puerto Rico; Energy Office:		
Energy Efficiency and Conservation Block Grant Program	81.128	139,740
Subtotal U.S. Department of Energy		<u>139,740</u>
U.S. Department of Agriculture		
Pass-through Governor's Office of Child Services and Community Development:		
Child and Adult Care Food Program	10.558	32,016
Pass-through USDA Rural Development:		
Housing Preservation Grants (HPG)	10.433	19,482
Subtotal U.S. Department of Agriculture		<u>51,498</u>
U.S. Department of Education (DE)		
Pass-through Education Department, Commonwealth of Puerto Rico:		
Even Start-State Educational Agencies	84.213	193,070
Subtotal U.S. Department of DE		<u>193,070</u>
U.S. Department of Health and Human Services (HHS)		
Pass-through the Office of Administration for Children and Families:		
Child Care and Development Block Grant	93.575	467,818
Subtotal U.S. Department of HHS		<u>467,818</u>
U.S. Department of Justice		
Pass-through Department of Justice, Commonwealth of Puerto Rico		
Recovery Act – Edward Byrne Memorial Justice Assistance Grant (JAG) Program	16.804	212,998
Subtotal U.S. Department of Justice		<u>212,998</u>
U.S. Department of Homeland Security		
Pass-through Governor's Office:		
National Incident Management System (NIMS)	97.107	10,000
Subtotal U.S. Department of Homeland Security		<u>10,000</u>
TOTAL		<u>\$ 2,523,800</u>

See notes to Schedule of Expenditures of Federal Awards.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Ciales and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Expenditures as per basic financial statements:	
Federal expenditures included within other governmental funds	<u>\$2,523,800</u>
Total expenditures per schedule of expenditures of federal awards	<u>\$2,523,800</u>

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Ciales, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated December 20, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs that we consider to be significant deficiencies in internal control over financial reporting as items 11-A and 11-B.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Ciales' 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 test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and which are described in the accompanying schedule of findings and questioned costs as items 11-A and 11-B.

This report is intended solely for the information and use of the audit committee, Commissioner Office of Municipal Affairs, management and the 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.

San Juan, Puerto Rico
December 20, 2011

The stamp E18861 was affixed
to the original of this report.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

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

Compliance

We have audited Municipality of Ciales' compliance with the types of compliance requirements described in the *U. S. Office of Management and Budget OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each Municipality of Ciales' major federal programs for the year ended June 30, 2011. Municipality of Ciales' 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 of Ciales' management. Our responsibility is to express and opinion on Municipality of Ciales' 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. 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 of Ciales' 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 on Municipality of Ciales compliance with those requirements.

As described in item 11-1 in the accompanying schedule of findings and questioned costs, Municipality of Ciales, did not comply with requirements regarding cash management that are applicable to its Housing Choice Voucher Program. Compliance with such requirements is necessary, in our opinion, Municipality of Ciales, to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality of Ciales 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, 2011.

Internal Control over Compliance

Management of Municipality of Ciales 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 of Ciales internal control over compliance with 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 first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. 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 11-1 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

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 did not identify any deficiencies in internal control over compliance that we consider to be significant deficiency, as defined above.

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 Municipality's response and, accordingly, we express no opinion on it.

This report is intended solely for the information of the management, Commissioner Office of Municipal Affairs, others within the entity and the 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.

San Juan, Puerto Rico
December 20, 2011

Ortiz, Rivera, Rivera & Co.

The stamp E18862 was affixed to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

1. SUMMARY OF AUDIT RESULTS

Financial Statements

Type of auditor's report issued: Unqualified opinion

Internal control over financial reporting:

Material weakness (es) identified? Yes X No

Significant deficiency (ies) identified? X Yes No

Noncompliance material to financial statements noted? Yes X No

Federal Awards

Internal control over major programs:

Material weakness (es) identified? X Yes No

Significant deficiency (ies) identified? Yes X No

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

Any audit findings disclosed that are required to be reported in accordance with section 510 (a) of OMB Circular A-133? Yes X No

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of federal programs or Cluster</u>
14.228	Community Development Block Grant (SBGP)
14.257	Homelessness Prevention and Rapid Re-Housing

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

b. Finding 11-B

Analytical review procedures performed as a part of the audit revealed that the budget compared to actual indicates that the Municipality consistently overstates budgeted revenues. This has the effect in the budget process that causes also an inflated level of expenditures. Because the higher revenues are not realized and expenditures are not adjusted, an operating deficit results.

We strongly recommend take the following steps to realistically budget for its operations:

- Management should immediately undertake a thorough review and comparison of the budget to current actual fiscal year revenues and expenses.
- Total expense budgeted should then be based on the total estimated revenue less a certain margin to add to fund balances at year-end or at minimum to break even for the year.
- The year budgeted revenue should be based on actual amounts earned in year through year, which result in the development of a more conservative and realistic budget.
- Any new or additional revenue sources being developed should be budgeted only when they are realized.
- Development and practice of a formal process of comparing the periodic budget to actual revenues and expenses by the management, with timely revisions as needed, should be commence.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM AUDIT

a. Section 8 Housing Choice Voucher - CFDA No. 14.871

• **Condition 11-1**

The program made loans to the General Fund and other federal programs, during fiscal year 2010-2011, amounting to \$67,000.

Criteria

Based on 24 CFR Section 570.207, ineligible activities, expenses to carry out the regular responsibilities of the unit of general local government are not eligible for assistance under this part.

Cause

The Municipality wasn't aware of the federal restrictions concerning federal funds, and use them for the general and special funds immediate needs.

Effect

The Municipality is not in compliance with Agency regulations.

Recommendation

The Municipality should reimburse the amount due and avoid this procedure immediately.

Questioned Costs

\$67,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
SCHEDULE OF STATUS OF PRIOR YEARS
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Years Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CIALES
SCHEDULE OF STATUS OF PRIOR YEARS
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
SBGP - CFDA No. 14.228	Condition 10-1 The Federal Program Office did not request the extensions for the year programs contracts (OCAM) on time.	Condition was corrected.
ARRA Child Care - CFDA No. 93.715	Condition 10-2 The contract related to construction purpose did not include the Davis Bacon Act clause.	Condition was corrected.
Child Care – CFDA No. 93.575	Condition 10-3 The reports were submitted after the time required.	Condition was corrected.
SBGP - CFDA No. 14.228	Condition 09-1 The Federal Program Office did not request the extensions for the year programs contracts (OCAM) on time.	Condition was corrected.

EXHIBIT I

CORRECTIVE ACTION PLAN

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Estado Libre Asociado de Puerto Rico
Gobierno Municipal de Ciales

HON. LUIS "ROLAN" MALDONADO RODRIGUEZ
ALCALDE



P.O. BOX 1408
CIALES, P.R. 00638
TEL. (787) 871-3636
(787) 871-3637
FAX: (787) 871-1710

CORRECTIVE ACTION PLAN

December 20, 2011

Cognizant or Oversight Agency for Audit:

Municipality of Ciales respectfully submits the following corrective action plan for the year ended June 30, 2011.

Name and address of independent public accounting firm: Ortiz, Rivera, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2011.

The findings from the June 30, 2011 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS - FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Finding 11-1: Section 8 Housing Choice Voucher - CFDA No. 14.871

Reportable Condition: See Condition 11-1

Recommendation:

The Municipality should reimburse the amount due and avoid this procedure immediately.

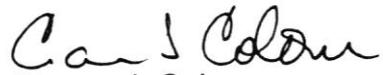
Action taken:

The Municipality reimbursed part of the funds and the remaining balance will be reimburse as soon as soon as possible.

"Ciales Puerta de la Cordillera Central"

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call
Carmen I. Colom at (787) 871-3636.

Cordially,



Carmen I. Colom
Federal Program Director

