

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**BASIC FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION**

FISCAL YEAR ENDED JUNE 30, 2013

(WITH THE ADDITIONAL REPORTS AND INFORMATION REQUIRED BY  
THE GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133)



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**AICPA** Governmental  
Audit Quality Center

Member of: American Institute of Certified Public Accountants (AICPA)  
Puerto Rico Society of Certified Public Accountants  
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**PART I**  
**FINANCIAL**

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## INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and  
Member of the Municipal Legislature  
Autonomous Municipality of Fajardo  
Fajardo, Puerto Rico

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise **Municipality's** basic financial statements as listed in the Table of Contents.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

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

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

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

**INDEPENDENT AUDITOR'S REPORT**  
**To the Honorable Mayor and**  
**Member of the Municipal Legislature**  
**Autonomous Municipality of Fajardo of the**  
**Commonwealth of Puerto Rico**  
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***Basis for Qualified Opinion on Governmental Activities***

During our audit the **Municipality** did not provide a subsidiary of capital assets that agreed with the amounts reported in governmental activities of the Governmental-Wide Financial Statements and, accordingly, the depreciation expense on those assets is not supported. Accounting principles generally accepted in the United States of America require that those capital assets been supported to present the assets, net position, and expense of the governmental activities. The amount by which this departure would affect the assets, net position, and expenses of the governmental activities has not been determined.

***Qualified Opinion***

In our opinion, except for the effects of the matters discussed in the "Basis for Qualified Opinion" paragraph, the financial statements referred to above present fairly, in all material respect, the respective financial position of the governmental activities of the **Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico**, as of June 30, 2013, and the respective changes in financial position thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

***Unmodified Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the **Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico**, as of June 30, 2013, and the respective changes in financial position thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis-of-Matter***

*Newly Adopted Standards*

As discussed in Note 24 to the financial statements, the **Municipality** adopted new accounting guidance, Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* effective July 1, 2012. Our opinion is not modified with respect to this matter.

*Restatement of Prior Year Financial Statements*

As discussed in Note 23 to the financial statements, the 2012 financial statements have been restated to correct misstatements. Our opinions is not modified with respect to this matter.

**INDEPENDENT AUDITOR'S REPORT**  
**To the Honorable Mayor and**  
**Member of the Municipal Legislature**  
**Autonomous Municipality of Fajardo of the**  
**Commonwealth of Puerto Rico**  
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***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 6 through 18, and budgetary comparison information on pages 55 and 56 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Supplementary Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality's** basic financial statements. The accompanying Financial Data Schedules – Section 8 Housing Choice Vouchers Program, as required by U.S. Department of Housing and Urban Development, on pages 58 through 60, and the Schedule of Expenditures of Federal Awards, as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organization*, on pages 62 through 64, are presented for purposes of additional analysis and are not required parts of the basic financial statements.

The accompanying Financial Data Schedules – Section 8 Housing Choice Vouchers Program and the Schedule of Expenditures of Federal Awards are the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Financial Data Schedules – Section 8 Housing Choice Vouchers Program and the Schedule of Expenditures of Federal Awards are fairly stated, in all material respects, in relation to the financial statements as a whole.

**INDEPENDENT AUDITOR'S REPORT**  
**To the Honorable Mayor and**  
**Member of the Municipal Legislature**  
**Autonomous Municipality of Fajardo of the**  
**Commonwealth of Puerto Rico**  
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**Other Reporting Required by *Governmental Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated May 29, 2014 on our consideration of the **Municipality's** internal control over financial reporting on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considered **Municipality's** internal control over financial reporting and compliance.



CPA Díaz-Martínez, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2016

Caguas, Puerto Rico  
May 29, 2014

Stamp No. E100052 was affixed to  
the original report.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

The following discussion and analysis of the Municipality of Fajardo's financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2013. Please read it in conjunction with the financial statements which follow this section.

**FINANCIAL HIGHLIGHTS**

**Highlights for Government-wide Financial Statements**

The government-wide financial statements report information about the Municipality as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2013 by \$148,968,562 (net position).
- Revenues increased by 469,098 and expenses increased by \$8,150,597 in comparison with year 2012, mainly due to improvements and maintenance of streets.
- Net change in net position amounted to \$631,579, a decrease of \$7,681,499 with respect to prior year (2012) net change.

**Highlights for Fund Financial Statements**

The fund financial statements provide detailed information about the Municipality's most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$84,420,774 a decrease of (\$6,048,968) in comparison with the prior year.
- The General Fund reported an excess of revenues over expenditures and other financing uses of \$4,672,658 and an unassigned fund balance of \$12,890,804. Unassigned fund balances decreased by \$2,552,170 from prior year.

**General Financial Highlights**

- The investment in net capital assets as of June 30, 2013 was \$91,621,956 (net of related debt).
- Other long term debts increases by \$1,406,504 and decreases from payments amounted to \$3,048,492, respectively.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$13,219,004. Revenues had a significant negative variance in the Volume of Business Taxes due to over estimate of \$755,091. Although the Municipality realized economies, principally in general government function of \$1,351,618, and in health and sanitation of \$1,902,264.

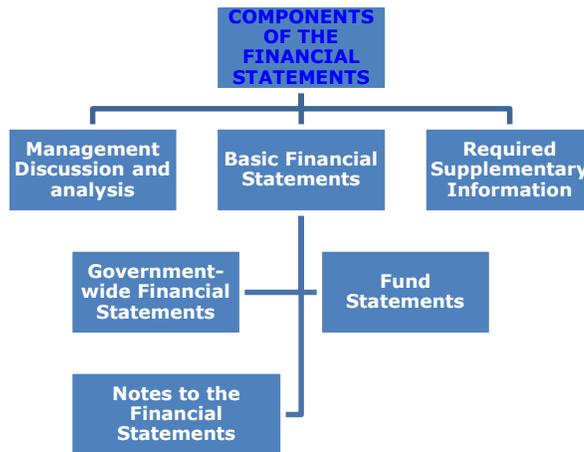
**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The Municipality's basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



The Municipality's basic financial statements consist of two kinds of statements, each with a different view of the Municipality's finances. The government-wide financial statements provide both long-term and short-term information about the Municipality's overall financial status. The fund financial statements focus on major aspects of the Municipality's operations, reporting those operations in more detail than the government-wide statements:

**Basic Financial Statements**

- ***Government-Wide Financial Statements***

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the *Statement of Net Position* – presents information on all of the Municipality's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in the Municipality's net position are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's roads and other infrastructure may need to be considered to assess the overall health of the Municipality. The second statement – the *Statement of Activities* – presents information showing how the net position changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

The government-wide statements reports as governmental activities the Municipality's basic services such as public safety, public works, health and sanitation, culture and recreation, human services and welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality's most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well by bond covenants.

The Municipality's basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The governmental fund statements focus on major funds. The Municipality's major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that complies with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

- ***Notes to the Financial Statements***

Provides integral information needed to explain the basis for the numbers used within the Basic Financial Statements and provide more detailed data.

**Required Supplementary Information**

Provides additional information to better understand the financial position of the Municipality and contains the Budgetary Comparison Schedule for the General Fund.

The Municipality of Fajardo in the Fiscal Year 2012-2013 implemented the following pronouncements, GASB-60, GASB-61, GASB-62, GASB-63, and GASB-65.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net position:**

The following table presents a summary of the Statements of Net Position as of June 30, 2013 and 2012:

Net position (assets plus deferred outflow less liabilities less deferred inflows) may serve over time as a useful indicator of a government's financial position. Net position for the year increased, with respect to prior year as the most significant changes were an increase in Net Investment in Capital Assets of \$6,207,512; and a decrease in restricted position of \$7,062,472.

<b>Table 1</b>		
<b>Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Statement of Net Position As of June 30, 2013</b>		
	<u><b>2013</b></u>	<u><b>2012</b></u>
Current and non-current assets .....	\$ 97,142,946	\$112,596,834
Capital assets .....	<u>101,264,150</u>	<u>94,322,856</u>
<b>Total Assets</b> .....	<b><u>198,407,096</u></b>	<b><u>206,919,690</u></b>
Current liabilities.....	5,047,852	9,338,645
Unearned revenues.....	5,436,428	6,176,615
Long-term liabilities .....	<u>38,954,254</u>	<u>43,067,447</u>
<b>Total Liabilities</b> .....	<b><u>49,438,534</u></b>	<b><u>58,582,707</u></b>
Net Investment in Capital Assets .....	91,621,956	85,414,444
Restricted.....	45,800,100	44,313,561
Unrestricted .....	<u>11,546,506</u>	<u>18,608,978</u>
<b>Total Net Position</b> .....	<b><u>\$148,968,562</u></b>	<b><u>\$148,336,983</u></b>

The largest portion of the Municipality's net position reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for total capital assets (\$101,264,150), net of accumulated depreciation (\$45,449,441) and less any related outstanding debt used to acquire or construct those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The

resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purposes of retiring debt.

Restricted net position represent resources that are subject to external restrictions on how they may be used.

Unrestricted net position are the part of the net position that can be used to finance day-to-day operations without constrains established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2013 the Municipality presented unrestricted net position of \$11,546,506. This balance was affected by long term obligations such as compensated absences \$2,477,000 and other debts for the amount of \$529,133 for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**Changes in Net Position:**

The following table summarizes the changes in net position for the years ended June 30, 2013 and 2012:

**Table 2**

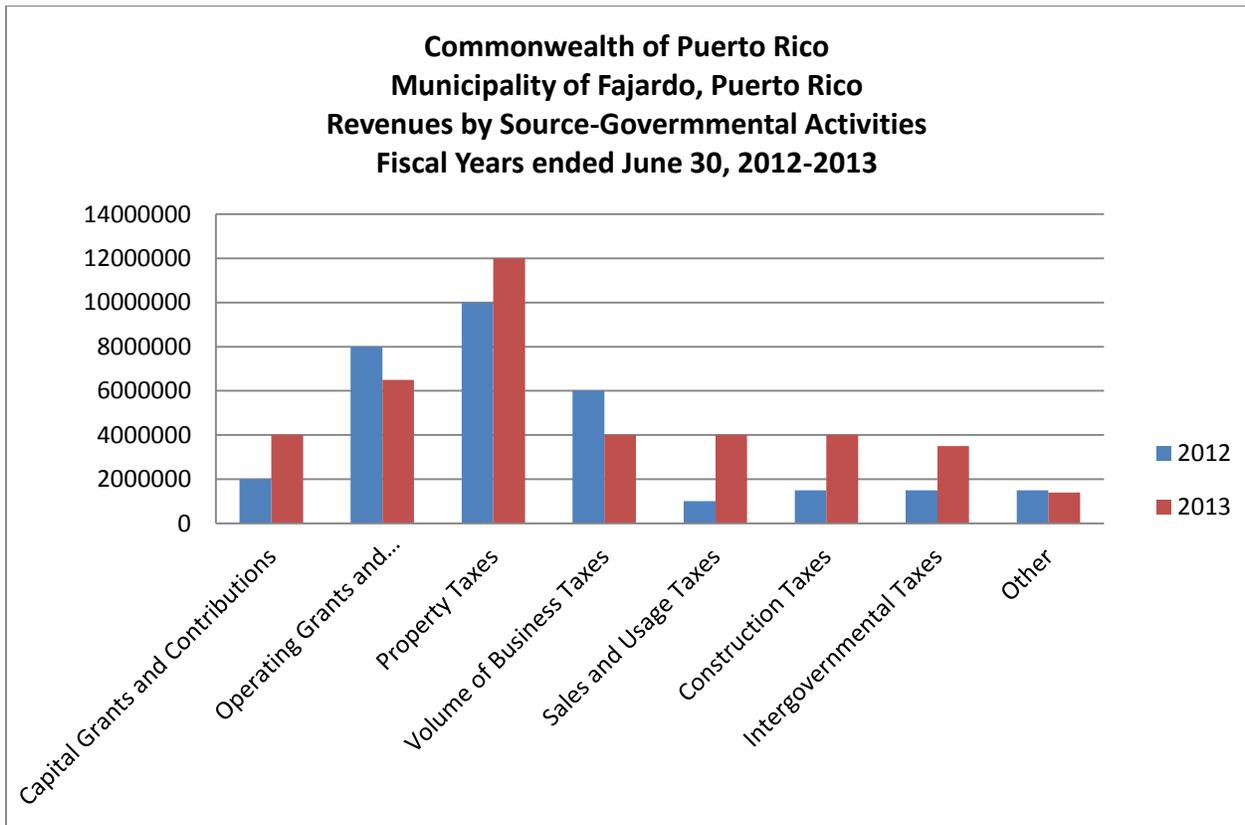
**Commonwealth of Puerto Rico  
Municipality of Fajardo  
Statement of Activities  
For Fiscal Years Ending June 30,**

	<u>2013</u>	<u>2012</u>
<b>Revenues:</b>		
Program Revenues:		
Changes for Services	\$ 336,328	\$ -
Operating Grants and Contributions	4,236,686	6,507,634
Capital Grants and Contributions	-	2,683,365
General Revenues:		
Property Taxes	13,965,976	12,454,886
Volume of Business Taxes	7,534,909	7,717,099
Sales and Usage Taxes	5,641,303	3,507,022
Construction Excise Taxes	1,717,101	1,147,822
Intergovernmental	4,485,543	3,229,480
Other General Revenues	1,329,657	1,531,097
<b>Total Revenues</b>	<b><u>39,247,503</u></b>	<b><u>38,778,405</u></b>
<b>Expenses:</b>		
General Administration	11,910,061	10,517,605
Public Safety	994,246	913,616
Public Works	2,107,379	2,942,026
Culture and Recreation	1,545,774	952,359
Health and Sanitation	3,493,982	337,745
Public Instruction	5,449,515	7,588,097
Human Services and Welfare	1,908,051	1,322,988
Urban Development	10,093,998	5,505,861
Interest Costs	1,112,918	385,030
<b>Total Expenses</b>	<b><u>38,615,924</u></b>	<b><u>30,465,327</u></b>
<b>Changes in Net Position</b>	<b>631,579</b>	<b>8,313,078</b>
Net Position-Beginning, as Restated	148,336,983	140,023,905
<b>Net Position-Ending</b>	<b><u>\$ 148,968,562</u></b>	<b><u>\$ 148,336,983</u></b>

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**Figure 1** presents revenues comparison by sources of the governmental activities during the past two years:

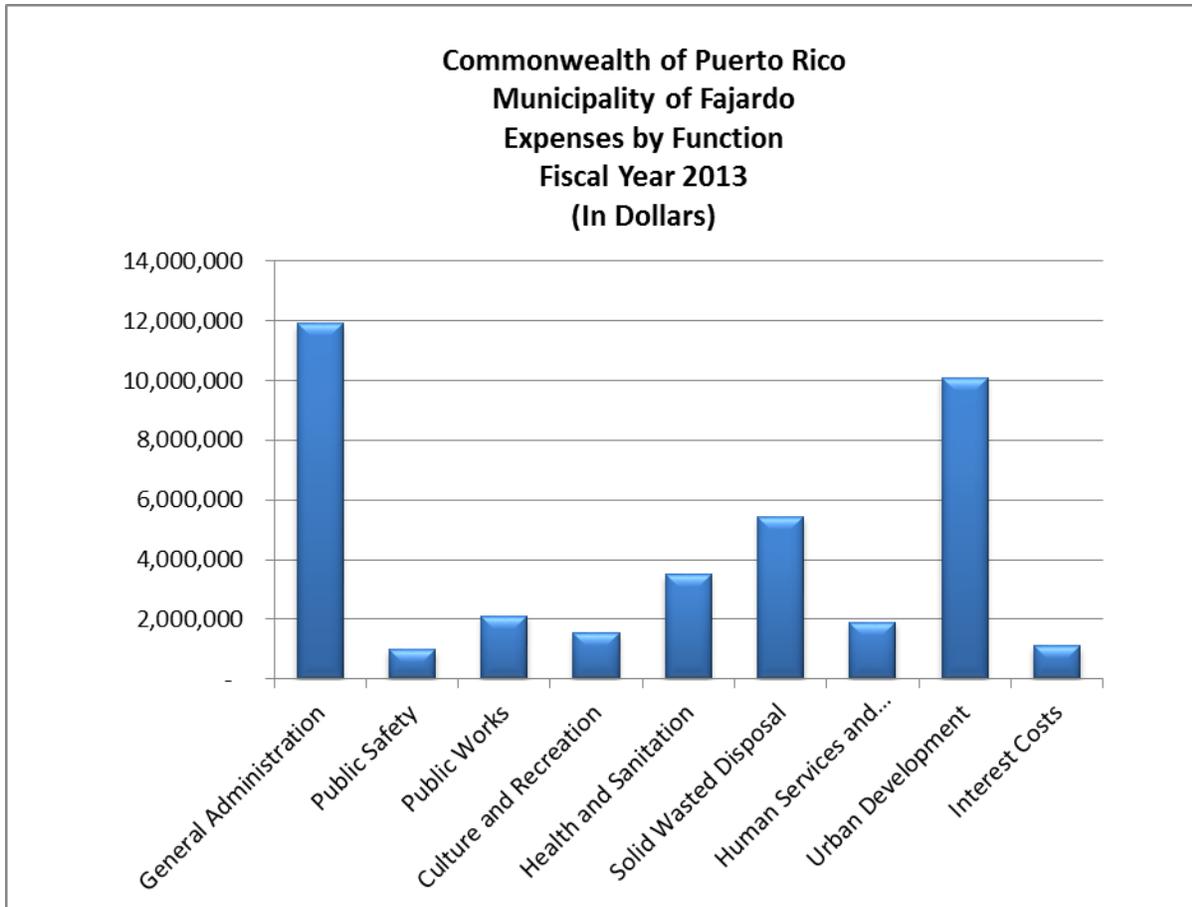
**FIGURE 1**



**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**Figure 2** presents expenses by function of the governmental activities during the fiscal year 2013-2012:

**FIGURE 2**



Approximately 11% of the Municipality's revenues came from intergovernmental, 36% from property taxes, 11% from grants and contributions and 42% from other sources. The Municipality's expenses cover a range of services. The largest expenses are general government with 31%, urban development with 26%, public instruction with 14%, and health and sanitation with 9%. Program revenues of the Municipality covered 12% of total expenses.

With respect to prior year, revenues increased by approximately \$469,098 or 1%, principally on sales and usage taxes, property taxes and intergovernmental revenues.

Expenses increased 21% or \$8,150,597 in comparison with 2012 year. Significant increases were registered on benefits to employees, and donations and services incurred for the benefit of the community.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

The following table focuses on the cost of each of the Municipality's largest functions/programs as well as each functions/program's net cost (total cost less fees generated by the programs and program-specific intergovernmental aid):

**Table 3**

**Commonwealth of Puerto Rico  
Municipality of Fajardo  
Net Cost of Municipality's Governmental Activities  
For Fiscal Years Ended June 30,**

<b>Functions/Programs</b>	<b>Total Cost of Services</b>		<b>Net Cost of Services</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
General Administration	\$11,910,061	\$10,517,605	\$11,517,745	\$10,517,605
Public Safety	994,246	913,616	994,246	913,616
Public Works	2,107,379	2,942,026	2,107,379	2,942,026
Culture and Recreation	1,545,774	952,359	1,472,174	952,359
Health and Sanitation	3,493,982	337,745	3,493,982	337,745
Public Instruction	5,449,515	7,588,097	2,781,385	821,730
Human Services and Welfar	1,908,051	1,322,988	1,263,705	1,322,988
Urban Development	10,093,998	5,505,861	9,299,376	3,081,229
Others	1,112,918	385,030	1,112,918	385,030
<b>Total</b>	<b>\$38,615,924</b>	<b>\$30,465,327</b>	<b>\$34,042,910</b>	<b>\$21,274,328</b>

Some of the cost of governmental activities in 2013 were paid by those who directly benefited from the programs and other governments and organizations that subsidized certain programs with grants and contributions, \$4,573,014. The net cost of services, \$34,042,910 was substantially covered by other general revenues including property, volume of business license taxes and intergovernmental.

**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS**

**Governmental Funds**

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

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT’S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

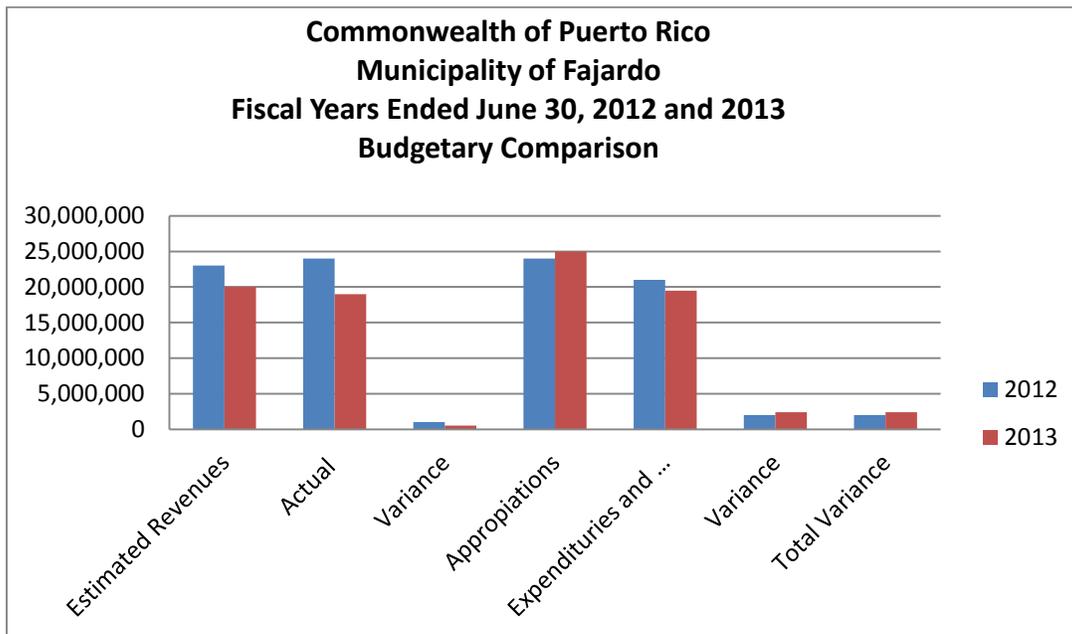
For the Fiscal year ended June 30, 2013, the governmental funds reported combined ending fund balances of \$84,420,774 a net decrease of \$(6,048,968) in comparison with the prior year. This increase was caused primarily by a net change in the non-major funds corresponding to the uses of prior year fund balance. Of total combined fund balances, \$12,890,804 constitutes unassigned fund balance of general. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unassigned fund balance of the general fund represents approximately 98% of total ending general fund balance. For the year ended June 30, 2013, the fund balance of the general fund decreased by (\$3,267,910), when compared with the prior year. The principal component of the net decreases were transferred to capital project funds for the improvement and constructions of facilities and infrastructure.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The general fund original budget for the fiscal period 2012-2013 presented an increase of 5% with respect to prior year budget. The Municipality does not included as an amendment to the budget the reduction on projected revenues in property taxes and miscellaneous revenues. Budget expenditures were amended during the year in accordance with additional revenues and functions estimates (see **Figure 3** below).

**FIGURE 3**



The negative variance of between revised budget and actual expenditures was due mainly to reduction in revenue as explained in the preceding paragraph in excess of economies in some functions. The Municipality reported less expenditure than appropriations in those functions for payments to purchase of supplies, professional and nonprofessional services.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital Assets**

At the end of the fiscal year, the Municipality has invested \$101,264,150 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, and equipment. This amount represents a net increase of \$6,941,294 or 7% from the prior year.

**Table 4**

**Commonwealth of Puerto Rico  
Municipality of Fajardo  
Capital Assets, Net  
As of June 30,**

	<b>Governmental Activities</b>	
	<b>2013</b>	<b>2012</b>
<b>Non-depreciable assets:</b>		
Land and Construction in Progress	\$ 44,349,132	\$ 42,356,505
Others	765,615	765,615
<b>Depreciable assets:</b>		
Buildings	30,005,866	28,841,793
Infrastructure	25,287,694	21,352,135
Equipment and Vehicles	182,514	483,237
Heavy Equipment	673,329	523,571
<b>Total</b>	<b>\$101,264,150</b>	<b>\$ 94,322,856</b>

The Municipality acquired a total of \$8,435,554 of capital assets during the fiscal year 2013-2012 as follows:

- Land - \$519,800
- Acquisition of Equipment and Vehicles – \$339,755
- Buildings and Improvements and Infrastructure-\$6,103,172
- Construction in Progress- \$1,472,827

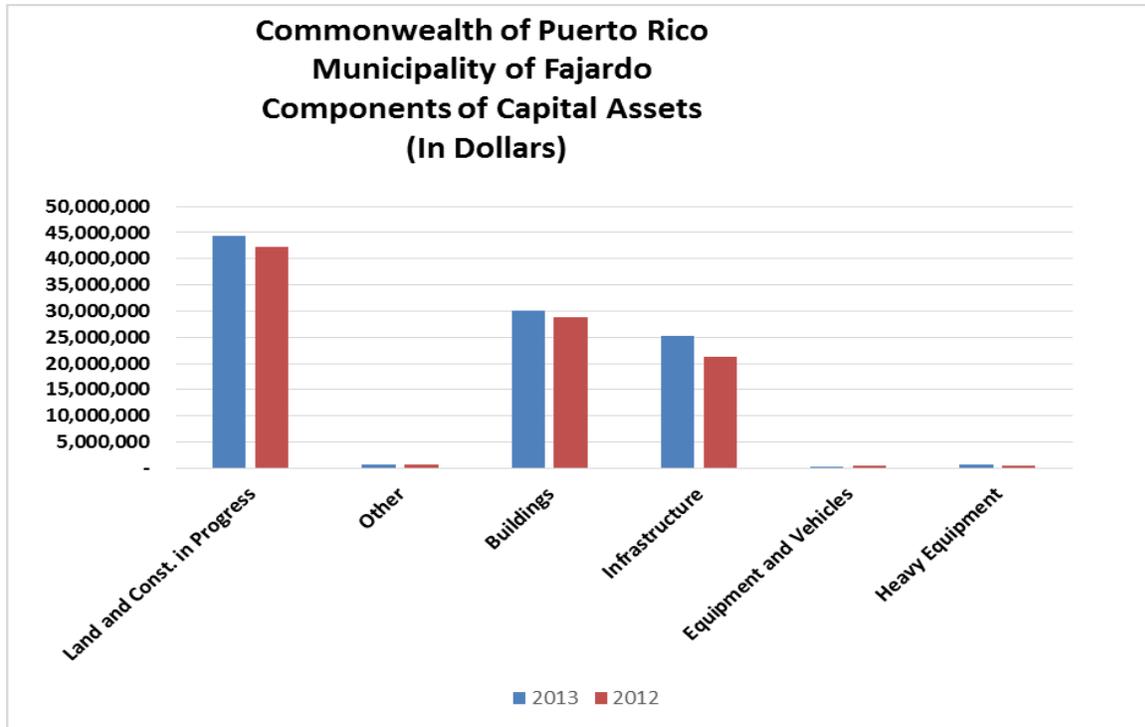
Other projects related to repair and maintenance of roads (not capitalized) were developed during the fiscal year 2014.

More detailed information about the Municipality's capital assets is presented in Note 10 to the financial statements.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

Figure 4 below present the components of capital assets during the fiscal years 2013 and 2012:

**FIGURE 4**



**Long-Term Debt**

At year-end, the Municipality had \$42,400,133 in general and special obligation bonds, an decrease of 4% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2013 and 2012:

**Table 5**

**Commonwealth of Puerto Rico  
Municipality of Fajardo  
Outstanding Long-Term Debts  
As of June 30,**

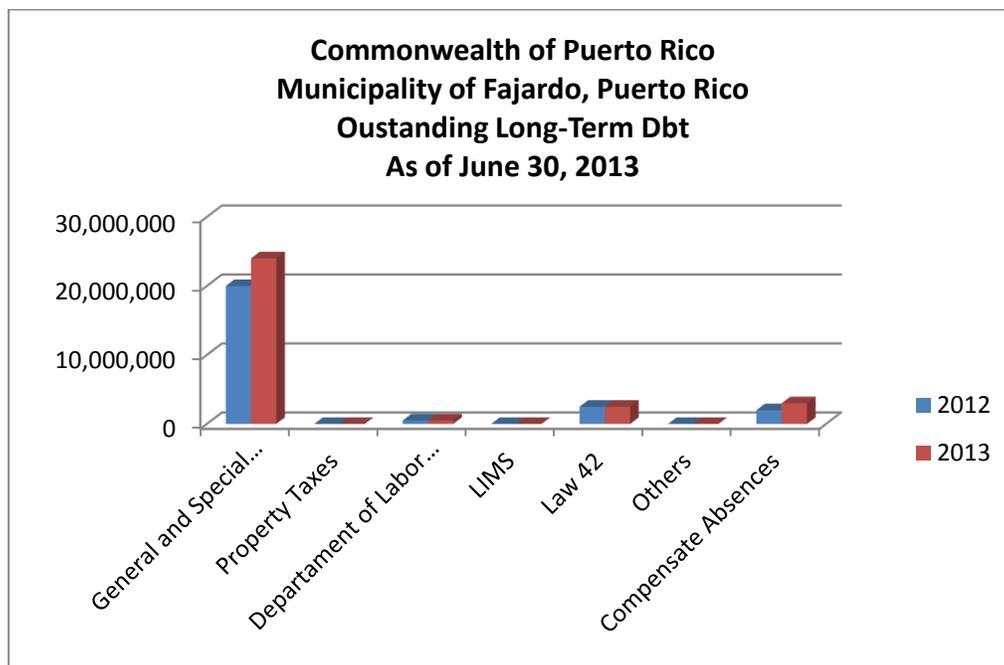
	<b>Governmental Activities</b>	
	<b>2013</b>	<b>2012</b>
General and Special Obligations	\$39,394,000	\$41,747,000
Law No. 42-MRCC	195,269	200,329
Christmas Bonus	333,864	275,974
Compensated Absences	2,477,000	1,818,818
<b>Total</b>	<b><u>\$42,400,133</u></b>	<b><u>\$44,042,121</u></b>

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

The decrease in the others debts is due to recognition of unemployment benefits. More detailed information about the Municipality's long term liabilities is presented in Note 11 to the financial statements.

**Figure 5** presents the components of long-term debts during the fiscal year 2012 and 2013:

**FIGURE 5**



**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2012-2013 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 14.9%, which compares with the Commonwealth rate of 13.7%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2014 are \$22 million, approximately \$1,000,000 less than the fiscal year 2013. The Municipality expects an decrease in revenues for the next years due to an expected decrease in revenues. Budgeted expenditures are expected to stabilize accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with economic injection projected when the construction project promoted by the Municipality and others private projects were develop during the year.

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

**CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Finance Department at (787) 863-1802 or PO Box 865, Fajardo, Puerto Rico.

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	<b>GOVERNMENTAL ACTIVITIES</b>
<b>ASSETS:</b>	
Cash	\$ 38,170,131
Cash with Fiscal Agent	53,907,479
Receivables (Net):	
Federal Grants	3,298,618
Due from Government Units	408,532
Municipal Revenue Collection Center	921,877
Sales and Usage Taxes	<u>436,309</u>
Capital Assets:	
Land and Construction in Progress	45,114,747
Other Capital Assets [Net of Accumulated Depreciation]	<u>56,149,403</u>
Total Capital Assets	<u>101,264,150</u>
<b>TOTAL ASSETS</b>	<b><u>198,407,096</u></b>
<b>LIABILITIES:</b>	
Accounts Payable and Accrued Expenses	806,013
Accrued Interest	548,068
Due to Governmental Units	247,892
Unearned Revenues	5,436,428
Noncurrent Liabilities:	
Due Within One Year	3,445,879
Due in More than One Year	<u>38,954,254</u>
<b>TOTAL LIABILITIES</b>	<b><u>49,438,534</u></b>
<b>NET POSITION:</b>	
Net Investment in Capital Assets	91,621,956
Restricted for:	
Head Start	1,198,665
Debt Service	24,057,640
Community Development Projects	82,351
Other Purpose	20,461,444
Unrestricted	<u>11,546,506</u>
<b>TOTAL NET POSITION</b>	<b><u>\$ 148,968,562</u></b>

The accompanying Notes to the Basic Financial Statements are an integral part of this statement.

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenues and Changes in Net Position
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
<b>Governmental Activities:</b>					
Mayor and Municipal Assembly	\$ 2,758,725	\$ -	\$ -	\$ -	\$ (2,758,725)
General Government	9,151,336	336,328	55,988	-	(8,759,020)
Public Safety	994,246	-	-	-	(994,246)
Public Works	2,107,379	-	-	-	(2,107,379)
Culture and Recreation	1,545,774	-	73,600	-	(1,472,174)
Health and Sanitation	3,493,982	-	-	-	(3,493,982)
Public Instruction	5,449,515	-	2,668,130	-	(2,781,385)
Human Services and Welfare	1,908,051	-	644,346	-	(1,263,705)
Urban Development	10,093,998	-	794,622	-	(9,299,376)
Interest on Long-Term Debt	1,112,918	-	-	-	(1,112,918)
<b>Total Governmental Activities</b>	<b>\$ 38,615,924</b>	<b>\$ 336,328</b>	<b>\$ 4,236,686</b>	<b>\$ -</b>	<b>(34,042,910)</b>
<b>General Revenues:</b>					
Taxes:					
Property Taxes, levied for General Purposes					8,631,423
Property Taxes, levied for Debt Service					5,334,553
Sales and Usage Taxes					5,641,303
Volume of Business Taxes					7,534,909
Construction Excise Taxes					1,717,101
Intergovernmental					4,485,543
Miscellaneous					1,329,657
<b>Total General Revenues</b>					<b>34,674,489</b>
<b>CHANGES IN NET POSITION</b>					<b>631,579</b>
Net Position – Beginning of Year, as Restated					148,336,983
<b>NET POSITION – ENDING OF YEAR</b>					<b>\$ 148,968,562</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO

BALANCE SHEET – GOVERNMENTAL FUNDS  
JUNE 30, 2013

	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	LOAN \$21,490,000 FUND	ARTS CENTER FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
<b>ASSETS:</b>								
Cash	\$ 16,644,059	\$ 320,235	\$ 4,047,429	\$ -	\$ -	\$ -	\$ 17,158,408	\$ 38,170,131
Cash with Fiscal Agent	-	-	-	16,595,074	8,003,660	24,021,188	5,287,557	53,907,479
Receivables:								
Property Taxes	337,357	-	-	-	-	584,520	-	921,877
Federal Grants	-	2,186,851	-	-	-	-	1,111,767	3,298,618
Sales and Usage Taxes	-	-	436,309	-	-	-	-	436,309
Due from Other Funds	2,460,543	-	-	-	-	-	-	2,460,543
Due from Governmental Units	166,932	-	-	-	-	-	241,600	408,532
<b>Total Assets</b>	<b>\$ 19,608,891</b>	<b>\$ 2,507,086</b>	<b>\$ 4,483,738</b>	<b>\$ 16,595,074</b>	<b>\$ 8,003,660</b>	<b>\$ 24,605,708</b>	<b>\$ 23,799,332</b>	<b>\$ 99,603,489</b>
<b>LIABILITIES:</b>								
Account Payable	\$ 266,001	\$ 143,573	\$ 194,825	\$ -	\$ -	\$ -	\$ 201,614	\$ 806,013
Bond Payable	-	-	-	-	-	2,536,000	-	2,536,000
Accrued Interest	-	-	-	-	-	548,068	-	548,068
Due to Governmental Units	214,120	-	-	-	-	-	33,772	247,892
Due to Other Funds	-	1,164,848	-	87,732	-	-	1,207,963	2,460,543
Unearned Revenues	5,436,428	-	-	-	-	-	-	5,436,428
<b>Total Liabilities</b>	<b>5,916,549</b>	<b>1,308,421</b>	<b>194,825</b>	<b>87,732</b>	<b>-</b>	<b>3,084,068</b>	<b>1,443,349</b>	<b>12,034,944</b>
<b>DEFERRED INFLOWS OF RESOURCES:</b>								
Unavailable Revenues - Commonwealth of Puerto Rico	166,932	-	-	-	-	-	-	166,932
Unavailable Revenues - MRCC	337,357	-	-	-	-	584,520	-	921,877
Unavailable Revenues - Federal Grants	-	1,198,665	-	-	-	-	860,297	2,058,962
<b>Total Deferred Inflows of Resources</b>	<b>504,289</b>	<b>1,198,665</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>584,520</b>	<b>860,297</b>	<b>3,147,771</b>
<b>FUND BALANCES:</b>								
Restricted	-	-	4,288,913	16,507,342	8,003,660	20,937,120	14,926,332	64,663,367
Committed	-	-	-	-	-	-	6,569,354	6,569,354
Assigned	297,249	-	-	-	-	-	-	297,249
Unassigned	12,890,804	-	-	-	-	-	-	12,890,804
<b>Total Fund Balances</b>	<b>13,188,053</b>	<b>-</b>	<b>4,288,913</b>	<b>16,507,342</b>	<b>8,003,660</b>	<b>20,937,120</b>	<b>21,495,686</b>	<b>84,420,774</b>
<b>Total Liabilities, Deferred Inflows of Resources and Fund Balances</b>	<b>\$ 19,608,891</b>	<b>\$ 2,507,086</b>	<b>\$ 4,483,738</b>	<b>\$ 16,595,074</b>	<b>\$ 8,003,660</b>	<b>\$ 24,605,708</b>	<b>\$ 23,799,332</b>	<b>\$ 99,603,489</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this statement.

<b>Total Fund Balances – Government Funds (Page 21)</b>	<b>\$ 84,420,774</b>
Amount reported for Governmental Activities in the Statement of Net Position (Page 19) are different because:	
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:	
Non Depreciable Capital Assets	\$ 45,114,747
Depreciable Capital Assets	101,598,844
Accumulated Depreciation	<u>(45,449,441)</u>
Total Capital Assets	101,264,150
Some of the <b>Municipality's</b> revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are unavailable in the funds:	
Christmas Bonus Reimbursement	166,932
Property Taxes - General Fund	337,357
Property Taxes Debt Service Fund	584,520
Federal Programs - Other Funds	860,297
Head Start Program	<u>1,198,665</u>
Total Unavailable Revenues	3,147,771
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:	
General Bonds	(36,858,000)
Christmas Bonus	(333,864)
Law Number 42-MRCC	(195,269)
Compensated Absences	<u>(2,477,000)</u>
Total Long-Term Liabilities	<u>(39,864,133)</u>
<b>Total Net Position of Governmental Activities (Page 19)</b>	<b><u>\$ 148,968,562</u></b>

COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCES – GOVERNMENTAL FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	LOAN 21,490,000 FUND	ARTS CENTER FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
<b>REVENUES:</b>								
Property Taxes	\$ 8,294,066	\$ -	\$ -	\$ -	\$ -	\$ 4,750,033	\$ -	\$ 13,044,099
Volume of Business Taxes	7,534,909	-	-	-	-	-	-	7,534,909
Sales and Usage Taxes	-	-	4,475,777	-	-	1,165,526	-	5,641,303
Federal Grants	-	5,187,841	-	-	-	-	1,745,739	6,933,580
Intergovernmental	4,594,585	-	-	-	-	-	165,540	4,760,125
Construction Excise Taxes	1,717,101	-	-	-	-	-	-	1,717,101
Rent	336,328	-	-	-	-	-	-	336,328
Miscellaneous	1,326,315	-	-	-	-	-	39,478	1,365,793
<b>Total Revenues</b>	<b>23,803,304</b>	<b>5,187,841</b>	<b>4,475,777</b>	<b>-</b>	<b>-</b>	<b>5,915,559</b>	<b>1,950,757</b>	<b>41,333,238</b>
<b>EXPENDITURES:</b>								
Current:								
Mayor and Municipal Legislature	2,758,725	-	-	-	-	-	-	2,758,725
General Government	7,655,834	-	-	-	-	-	101,435	7,757,269
Public Safety	914,246	-	-	-	-	-	-	914,246
Public Works	1,706,659	-	-	-	-	-	-	1,706,659
Culture and Recreation	1,339,234	-	-	-	-	-	-	1,339,234
Health and Sanitation	3,493,982	-	-	-	-	-	-	3,493,982
Public Instruction	-	5,385,783	-	-	-	-	63,732	5,449,515
Human Services and Welfare	904,833	-	-	-	-	-	1,003,218	1,908,051
Urban Development	-	-	4,528,004	-	-	-	5,436,989	9,964,993
Capital Outlay	339,755	-	-	3,786,646	9,000	-	4,300,153	8,435,554
Debt Service:								
Principal	5,060	-	-	-	-	2,536,000	-	2,541,060
Interest and Other Charges	12,318	-	-	-	-	1,100,600	-	1,112,918
<b>Total Expenditures</b>	<b>19,130,646</b>	<b>5,385,783</b>	<b>4,528,004</b>	<b>3,786,646</b>	<b>9,000</b>	<b>3,636,600</b>	<b>10,905,527</b>	<b>47,382,206</b>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES</b>	<b>4,672,658</b>	<b>(197,942)</b>	<b>(52,227)</b>	<b>(3,786,646)</b>	<b>(9,000)</b>	<b>2,278,959</b>	<b>(8,954,770)</b>	<b>(6,048,968)</b>
<b>OTHER FINANCING SOURCES (USES):</b>								
Transfers – In	-	-	-	-	-	-	7,940,568	7,940,568
Transfers – Out	(7,940,568)	-	-	-	-	-	-	(7,940,568)
<b>Total Other Financing Sources (Uses)</b>	<b>(7,940,568)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>7,940,568</b>	<b>-</b>
<b>Net Change in Fund Balances</b>	<b>(3,267,910)</b>	<b>(197,942)</b>	<b>(52,227)</b>	<b>(3,786,646)</b>	<b>(9,000)</b>	<b>2,278,959</b>	<b>(1,014,202)</b>	<b>(6,048,968)</b>
Fund Balances – Beginning, as Restated	16,455,963	197,942	4,341,140	20,293,988	8,012,660	18,658,161	22,509,888	90,469,742
<b>FUND BALANCES – ENDING</b>	<b>\$ 13,188,053</b>	<b>\$ -</b>	<b>\$ 4,288,913</b>	<b>\$ 16,507,342</b>	<b>\$ 8,003,660</b>	<b>\$ 20,937,120</b>	<b>\$ 21,495,686</b>	<b>\$ 84,420,774</b>

The accompanying Notes to the Basic Financial Statements are an integral part of this statement.

<b>Net Change in Fund Balances – Government Funds (Page 23)</b>		<b>\$ (6,048,968)</b>
Amount reported for Governmental Activities in the Statement of Activities (Page 20) are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:		
Capital Assets	\$ 8,435,554	
Depreciation Expense	<u>(1,494,260)</u>	
Excess of Capital Outlays over Depreciation Expense		6,941,294
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds and vice versa:		
Head Start	(2,545,840)	
Christmas Bonus	(109,042)	
Federal Programs - Other Funds	(352,730)	
Property Taxes	<u>921,877</u>	
Total of Revenues		(2,085,735)
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced Noncurrent Liabilities in the Statement of Net Position. In the current period repayments were		
		2,541,060
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:		
Increase in Compensated Absences	(658,182)	
Christmas Bonus	<u>(57,890)</u>	
Total Additional Expenses		<u>(716,072)</u>
<b>Change in Net Position of Governmental Activities (Page 20)</b>		<b>\$ <u>631,579</u></b>

The accompanying Notes to the Basic Financial Statements are an integral part of this statement.

## 1. FINANCIAL REPORTING ENTITY

### A. Organization

The Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico (Municipality) was founded in the year 1775, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

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

### B. Reporting Entity

A reporting entity is comprised of (1) the primary government, (2) component unit organizations for which the primary government is financial accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and they are financially accountable to the primary government. 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 accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. GASB Accounting Standards Codification Section 2600, *Reporting Entity and Component Unit Presentation and Disclosure*, requires the inclusion of organizations that raise and hold funds for the direct benefit of the primary government.

GASB Accounting Standards Codification Section 2100, *Defining the Financial Reporting Entity*, describes the criteria for determining which organizations, functions, and activities should be considered part of the Municipality for financial reporting purposes. The primary criteria include appointing a voting majority of an organization's governing body, and the Municipality's ability to impose its will on that organization or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality. A second criteria used in evaluating potential component units is if the nature and significance of the relationship between the organization and a primary government are such that to exclude the organization from the financial reporting entity would render the financial statements misleading or incomplete.

A legally separate, tax-exempt organization should be discretely presented as a component unit if all of the following criteria are met: (a) the economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents; (b) the primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization, and; (c) the economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

**1. FINANCIAL REPORTING ENTITY – continuation**

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit’s balances and transactions in a manner similar to the presentation of the Municipality’s balances and transactions; and discrete – presentation of the component unit’s financial data in column separate from the Municipality’s balances and transactions. The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Based on these criteria, there are no other organizations which should be included in these basic financial statements.

These financial statements present the respective financial position of the governmental and business type activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2013, and the respective changes in financial position, and the cash flows, where applicable, thereof for the fiscal year then ended.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

***Government-wide Financial Statements***

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Nonexchange transactions, in which the Municipality gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been met, other than time requirements. These resources relate to a future period (when the advance is first permitted to be used in accordance with the government-mandated nonexchange transaction or a voluntary nonexchange transaction) and, therefore, should be classified as a deferred inflow of resources until such time as the resources are first permitted to be used. Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

***Governmental Fund Financial Statements***

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. “Available” means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Revenues that the Municipality earns by incurring obligations are recognized in the same period as when the obligations are recognized. At June 30, 2013, all revenues sources met this availability criterion.

Property taxes, volume of business taxes, sales and usage taxes, construction excise taxes, 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. Entitlements are recorded as revenues when all eligibility requirements are met, including any time requirements and the amount is received during the period or within the availability requirements have been met, and the amount is received during the period or within the availability period for this revenue source (60 days of year-end). Expenditures-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other eligibility requirements have been met, and the amount is received during the period or within the availability period for this revenue source (within 60 days of year-end). All other revenue items are considered to be measurable and available only when cash is received by the Municipality.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Expenditures are generally recognized when the related liability is incurred. However, debt service expenditures, as well as expenditures related to compensated absences, and claims and judgments, are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Principal and interest on bonds payable are recorded when they matured (when payment is due), except for principal and interest of bonds due on July 1, 2013, which are recorded as governmental fund liabilities of June 30, 2013 which is the date when resources were available in the debt service fund.

### B. Financial Statement Presentation

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

#### *Government-wide Financial Statements*

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

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

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

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

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

### ***Governmental Fund Financial Statements***

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

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

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

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

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

The model as defined in GASBS No. 34 established criteria for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major fund:

**General Fund** – This is the general operating fund of the Municipality. It is used to account for all financial resources, except those required to be accounted for in another fund.

**Head Start Fund** – This is the fund used to account for all transactions of the Head Start Program. The objectives to this program are to provide comprehensive health, educational, nutritional, social and other developmental services primarily to economically-disadvantaged pre-school children and infants and toddlers so that the Children will attain school readiness.

**Sales and Usage Taxes Fund** – This fund used to account for accumulation of resources for, and the payment of special purpose obligations.

**Loan \$21,490,000 Fund** – This fund used to account capital improvements through bond issuance.

**Arts Center Fund** – This is used to account for construction of an Arts center.

**Debt Service Fund** – This is used to account for the accumulation of resources for, and the payment of long-term debts principal and interests.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### C. Budgetary Data

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

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

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

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

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

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

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

### D. Cash, Cash Equivalent and Investment

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 Municipality's bank balances in commercial banks of approximately \$16.6 million in the general fund, \$320,235 in the Head Start Fund, \$4.0 million in the Sales and Usage Taxes Fund, and \$17.2 million in the Other Governmental Funds were fully collateralized at June 30, 2013. The deposits at GDB of approximately \$53.9 million that are restricted principally for capital projects, of which \$16.6 million are restricted for various capital projects, \$8.0 million that are restricted for the Art Center, and the \$24.0 million in the debt service fund. All are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks. 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.

### E. Receivable and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statement as "interfund balances".

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Receivables consist of all revenues earned but not collected at June 30, 2013. These account receivables are shown net of estimated allowances for uncollectible accounts, which are determined upon past collection experience, historical trends, and current economic conditions. Intergovernmental receivables in the general fund represent mostly sales and usage taxes, federal grant and contributions, property tax accounts that are levied by Municipal Revenue Collection Center (MRCC), a governmental entity created by the Commonwealth. Intergovernmental receivables in the other governmental funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded grant and contributions and state appropriations, and the amount in the debt service fund represents the distribution of property tax collected which is restricted for the debt service.

Accounts payable represent amounts, including salaries and wages, owed for goods and services received prior to year-end.

### F. Inventories

The Municipality used the purchase method to account for the purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. This method records items as expenditures, in the appropriate fund, when they are acquired and, accordingly, the inventory is not recorded in the basic financial statements.

### G. Capital Assets

Capital assets, which include land, buildings and improvement, machinery and equipment, motor vehicles, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the GWFS. Capital assets, other than infrastructure assets, are defined by the Municipality as assets with an initial, individual cost of more than \$500 (amount not rounded) and an estimated useful life in excess of two years. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. The Municipality reports infrastructure assets on a network and subsystem basis. Accordingly, the amounts spent for the construction or acquisition of infrastructure assets are capitalized and reported in the GWFS regardless of their amount.

In the case of the initial capitalization of general infrastructure assets (i.e., those reported by governmental activities) the Municipality chose to include all such items regardless of their acquisition date or amount.

The Municipality was able to estimate the historical cost for the initial reporting of these assets through back trending (i.e., estimating the current replacement cost of the infrastructure to be capitalized and using an appropriate price-level index to deflate the cost to the acquisition year or estimated acquisition year). As the Municipality constructs or acquires additional capital assets each period, including infrastructure assets, they are capitalized and reported at historical cost. The reported value excludes normal maintenance and repairs which are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate. In the case of donations the Municipality values these capital assets at the estimated fair value of the item at the date of its donation.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

Capital outlay is recorded as expenditures of the General Fund and other governmental funds and as assets in the GFFS to the extent the Municipality capitalization threshold is met. Depreciation and amortization expense is recorded only in the GWFS. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. No depreciation is recorded for land and construction in progress. The estimated useful lives of major capital asset categories are:

CAPITAL ASSETS	YEARS
Buildings	70
Improvement Other Than Buildings	70
Infrastructure	10-70
Vehicles and Furniture	5
Machinery and Equipment	5-10

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

The accounting policy for Works of Art is that they are capitalized at their historical cost or fair value at date of donation whether they are held as individual items or in a collection. Capitalized collections or individual items that is exhaustible, such as exhibits whose useful lives are diminished by display or educational or research applications, are depreciated over their estimated useful lives. Depreciation is not required for collections or individual items that are inexhaustible. At June 30, 2013, all Work of Art are considered inexhaustible.

Impaired capital assets that will no longer be used by the Municipality, if any, are reported at the lower of carrying value or fair value. Impairment losses on capital assets with physical damages that will continue to be used by the Municipality are measured using the restoration cost approach. Impairments of capital assets that are subject to a change in the manner or duration of use, or assets affected by enactment or approval of laws or regulations or other changes in environmental factors or assets that are subject to technological changes or obsolescence, if any, are measured using the service units approach.

**H. Deferred Outflows/Inflows of Resources**

In addition to assets, the Statement of Financial Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Municipality has no items that qualify for reporting in this category.

In addition to liabilities, the Statement of Financial Position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Municipality has no items that qualify for reporting in this category.

The Municipality has items, which arises only under a modified accrual basis of accounting that qualifies for reporting in deferred inflows of resources. Accordingly, the items, *unavailable revenue*, is reported only in the governmental funds Balance Sheet. The governmental funds report *unavailable revenues* from two sources: Christmas Bonus Reimbursement from the Commonwealth and Federal Grants. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### I. Unearned Revenues

In the GWFS, deferred revenues arise only when the Municipality receives resources before it has a legal claim to them. In the GFFS, arises when the following situations occur: potential revenue does not meet both the measurable and available criteria for revenue recognition in the current period.

### J. Long-Term Obligations, Bonds Issuance Costs, and Premium or Discount

The liabilities reported in the GWFS include the general and special obligation bonds, long-term notes, other noncurrent liabilities (e.g., vacation, sick leave, claims and judgments, noncurrent liabilities to other governmental entities and third parties, and landfill post closure care costs). Bond premiums and discounts, if any, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount, if any. As per GASB Statement No. 65, Bond Issuance Costs incurred are reported as expense in the fiscal year incurred.

In the GFFS, governmental fund types recognize bond premiums and discounts as other financing sources and uses, respectively, and bond issuance costs as debt service expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures. Expenditures for principal and interest payments for governmental fund general and special obligations bonds are recognized in the Debt Service Fund when due.

### K. Compensated Absences

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

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

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

### L. Claims and Judgments

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### M. Accounting for Pension Costs

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

For the purpose of applying the requirements of GASBS No. 27, as amended, the state government of the Commonwealth is considered to be the sponsor of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), a multiemployer cost-sharing defined benefit pension plan and System 2000, a hybrid defined contribution plan, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth and the basic financial statements of such retirement systems are part of the financial reporting entity of Commonwealth. Act No. 3 was enacted on April 4, 2013, amended the Act No. 447 for the purpose of establishing a major reform of the ERS effective on July 1, 2013 (see Note 16).

### N. Risk Financing

The Municipality carries commercial insurance to cover property and 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. Also, principal officials of the Municipality are covered under various surety bonds. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2013 amounted to approximately \$8,191. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$418,481 for workers compensation insurance covering all municipal employees for the same period.

### O. Inter-fund Transactions

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

*Inter-fund Transfers* – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

### P. Net Position/Fund Balance

#### 1) Net Position

Net position represent the difference between assets, deferred outflows of resources, liabilities, and deferred inflows of resources in the government-wide financial statements.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

The GWFS utilize a net position presentation, which are categorized as follow:

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

In addition, the outstanding debt attributed to capital assets does not include accrued interest payable, non-capital accrued liabilities, inter-fund loans and other financial assets.

Net investment in capital assets is comprised of the following:

	<u>Governmental Activities</u>
Capital Assets, Net of Accumulated Depreciation .....	\$101,264,150
Outstanding Balance on Related Debt.....	(33,394,000)
Unspent Capital Debt Proceeds.....	<u>29,751,806</u>
Net Investment in Capital Assets .....	<u>\$ 91,621,956</u>

- *Restricted Net Position* – These result when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Position* – These consist of net position which do not meet the definition of the two preceding categories. Unrestricted net position often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net position often have constraints on resources that are imposed by management, but can be removed or modified.

***Net Position Flow Assumption***

Sometimes the Municipality will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted net position and unrestricted net position in the government-wide and proprietary fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the Municipality’s policy to consider restricted net position to have been depleted before unrestricted net position is applied.

**2) Fund Balance**

***Fund Balance Classification***

Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the Municipality honors constraints on the specific purposes for which amounts in those funds can be spent.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The nonspendable classification contains amounts not in spendable form or legally or contractually required to be maintained intact. Restricted amounts contain restraints on their use externally imposed by creditors, grantors, contributors, or laws or regulation of other governments; or imposed by law through constitutional provisions or enabling legislation. Committed amounts can only be used for specific purposes imposed by formal action of the Municipality's highest level of decision-making authority. The highest level of decision-making authority is the Municipal Legislature and it takes a resolution to establish a fund balance commitment. Amounts intended to be used for specific purposes are assigned. Assignments should not cause deficits in the Unassigned Fund Balance. Unassigned Fund Balance is the residual classification for the General Fund.

### ***Fund Balance Flow Assumption***

Sometimes the Municipality will fund outlays for a particular purpose from both restricted and unrestricted resources (the total committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the GFFS a flow assumption must be made about the order in which the resources are considered to be applied. It is the Municipality's policy to consider restricted fund balance to have been depleted before using any of the components or unrestricted fund balance. Further, when the components of unrestricted fund balance can be used for the same purpose, committed fund balance is depleted first, followed by assigned fund balance. Unassigned fund balance is applied last.

### ***Fund Balance Policy***

The Municipality believes that sound financial management principles require that sufficient funds be retained by the Municipality to provide a stable financial base at all times. To retain this stable financial base, the Municipality needs to maintain a General Fund balance sufficient to fund all cash flows of the Municipality, to provide financial reserves for unanticipated expenditures and/or revenue shortfalls of an emergency nature, to provide funds for the disparity in timing between the collection of property taxes and other main income. The purpose of this policy is to specify the size and composition of the Municipality's financial reserves and to identify certain requirements for replenishing any fund balance reserves utilized.

### ***Policy on Committing Funds***

It is the policy of the Municipality that fund balance amounts will be reported as "Committed Fund Balance" only after formal action and approval by Municipal Legislature. The Municipal Legislature has the authority to separate funds for specific purposes. Any separate fund as Committed Fund Balance requires the adoption of a resolution by a simple majority of votes. The adoption of the resolution should be carried out before June 30 of the fiscal year to implement. If the actual amount of the commitment is not available through June 30, the resolution should establish the process or formula required to calculate the exact amount as soon as information is available in the following fiscal year.

For example, the Municipal Legislature may approve a resolution prior to year-end financial statements, if available, up to a specified dollar amount as Committed Fund Balance for capital projects. The exact dollar amount to be reported as Committed Fund Balance for capital projects may not be known at the time of approval due to the annual financial audit not yet being completed. This amount can be determined at a later date when known and appropriately reported within the year-end financial statements due to the Municipal Legislature approving this resolution before year-end.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

It is the policy of the Municipality that the Municipal Legislature may commit fund balance for any reason that is consistent with the definition of Committed Fund Balance. Examples of reasons to commit fund balance would be to display intentions to use portions of fund balance for future capital projects, stabilization funds, or to earmark special General Fund streams unspent at year-end that are intended to be used for specific purposes.

After approval by the Municipal Legislature, the amount reported as Committed Fund Balance cannot be reversed without utilizing the same process required to commit the funds. Therefore, it is the policy of the Municipality that funds can only be removed from the Committed Fund Balance category after resolution and approval by the Municipal Legislature.

### ***Policy on Assigning Funds***

Funds that are *intended* to be used for a specific purpose but have not received the formal approval action at the Municipal Legislature level may be recorded as Assigned Fund Balance. Likewise, redeploying assigned resources to an alternative use does not require formal action by the Municipal Legislature. Having reviewed the requirements for assigning fund balance, therefore, is the policy of the Municipality that Mayor shall have the authority to assign fund balance of the Municipality based on the intentions of the use of funds by the Municipal Legislature. In addition, the Mayor can delegate to the Finance Director or other employee of the Municipality, the authority to assign the funds.

### ***Policy on Unassigned General Fund Balance***

It is the goal of the Municipality to achieve and maintain an Unassigned General Fund Balance equal to 10% of budgeted expenditures. The Municipality considers a balance of less than 5% to be a cause for concern, barring unusual or deliberate circumstances, and a balance of more than 15% as excessive. An amount in excess of 15% is to be considered for reservation to accumulate funding for purchase of machinery and equipment, for capital projects, and/or to reduce the tax levy requirements, and shall be determined in conjunction with the annual budget process. In the event that the Unassigned General Fund Balance is less than the policy anticipates, the Municipality shall plan to adjust budget resources in the subsequent fiscal years to restore the balance.

Appropriation from Unassigned General Fund Balance shall require the approval of the Municipal Legislature and shall be only for specific disbursements, such as one-time expenditures and capital assets purchases, and not for ongoing expenditures unless a viable plan designated to sustain the expenditures is simultaneously adopted. The Municipality has met its GASB 54 fund balance targets at June 30, 2013.

### ***Prioritization of Fund Balance Use***

In circumstances where expenditure is for a purpose that quantities are available in multiple fund balance classifications, the order in which the resources will be used shall be as follows: Restricted Fund Balance, followed by Committed Fund Balance, Assigned Fund Balance, and last but not least, Unassigned Fund Balance.

## **Q. Use of Estimates**

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

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

**R. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS**

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

GASB Statement No. 66, *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

This Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement 54 and Statement No. 34, *Basic Financial Statements— and Management's Discussion and Analysis—for State and Local Governments*.

This Statement also amends Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012 (FY 2013-2014). Earlier application is encouraged.

GASB Statement No. 67, *Financial Reporting for Pension Plans*. This Statement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*, as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. The Statement builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement No. 67 enhances note disclosures and RSI for both defined benefit and defined contribution pension plans. Statement No. 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2013 (FY 2013-2014). Earlier application is encouraged.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27* as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The Statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014 (FY 2014-2015). Earlier application is encouraged.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2013 (FY 2014-2015). Earlier application is encouraged.

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to recognize revenue to the extent of the reduction in its guaranteed liabilities. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units. This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees. The provisions of this Statement are effective for reporting periods beginning after June 15, 2013 (FY 2013-2014). Earlier application is encouraged.

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. This Statement eliminates a potential source of understatement of restated beginning net position and expense in a government's first year of implementing GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. To correct this potential understatement, Statement 71 requires a state or local government, when transitioning to the new pension standards, to recognize a beginning deferred outflow of resources for its pension contributions made during the time between the measurement date of the beginning net pension liability and the beginning of the initial fiscal year of implementation. This amount will be recognized regardless of whether it is practical to determine the beginning amounts of all other deferred outflows of resources and deferred inflows of resources related to pensions. The provisions are effective simultaneously with the provisions of Statement 68, which is required to be applied in fiscal years beginning after June 15, 2014 (FY 2013-2014).

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

## 3. CASH, CASH EQUIVALENTS AND INVESTMENTS

Investments consist of certificates of deposit. The Municipality's cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$250,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

continue

**3. CASH, CASH EQUIVALENTS AND INVESTMENTS – continuation**

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws.

During the year, the Municipality invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2013, the market value of investments recorded in Special Revenue Fund approximated its carrying value as follow:

<u>Certificate of Deposit</u>	<u>Number</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Expiration Date</u>
Popular Bank	1110000048	\$2,600,000	0.35%	19/09/2014
Popular Bank	1110000050	<u>600,000</u>	0.35%	04/10/2014
		<u>\$3,200,000</u>		

**4. RECEIVABLES**

Other receivables for the fiscal year ended June 30, 2013 corresponds to the Puerto Rico Treasury Department (Christmas bonus).

**5. INTERFUND TRANSACTIONS**

Inter-fund receivables and payables balances at June 30, 2013 consisted of the following:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other Governmental Fund	\$1,207,963
General Fund	Loan \$21,490,000 Fund	87,732
General Fund	Head Start Fund	<u>1,164,848</u>
		<u>\$2,460,543</u>

Inter-fund transfers between the general and other governmental funds represents the creation of capital projects funds for different improvement projects and construction of new facilities.

**6. FEDERAL GRANTS AND OTHER RECEIVABLE**

Represents grants and contributions due from local and federal agencies:

Health and Human Services - Head Start	\$2,186,851
Community Development Block Grant/Entitlement Grant –CDBG	991,056
Homeless Prevention and Rapid Rehousing Program – HPRP	27,291
Child Care and Development Block Grant	<u>93,420</u>
	<u>\$3,298,618</u>

continue

**6. FEDERAL GRANTS AND OTHER RECEIVABLE – continuation**

Due from Governmental Units:

Puerto Rico Treasury Department (Christmas Bonus)	\$ 166,932
Puerto Rico Treasury Department (Act Number 52)	<u>241,600</u>
	<u>\$ 408,532</u>

**7. DUE TO OTHER GOVERNMENTAL UNITS**

As of June 30, 2013, balance Due to Governmental Units of the General Fund for services rendered to the Municipality, consists of the following:

General Services Administration	\$ 2,931
Employee's Retirement System	80,331
Puerto Aqueduct and Sewer Authority	2,100
Puerto Rico Secretary of the Treasury	29,007
Department of Labor	67,523
AEELA	<u>32,228</u>
	<u>\$ 214,120</u>

**8. UNEARNED REVENUES**

Government-wide Statement of Net Position does not report deferred inflows of resources, but report unearned revenues for resources receive before it has legal claim to them. Governmental funds balance sheet report unearned revenues in connection with cash collected for revenues that are not considered to be available to liquidate liabilities of the current period. The Unearned Revenues of \$5.4 million in the general fund are related to the Volume of Business Taxes.

**9. DEFERRED INFLOWS OF RESOURCES**

Government funds balance sheet report deferred inflows of resources in connection with receivables for revenues that are not considered to be available to liquidate of the current period (unavailable). Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred inflows of resources reported in the basic financial statement were as follows:

Governmental Funds:

Christmas Bonus- Commonwealth	\$ 166,932
Property taxes - MRCC	921,877
Federal Grants:	
Head Start	1,198,665
CDBG Fund	<u>860,297</u>
Total Deferred Inflows of Resources	<u>\$3,147,771</u>

continue

**10. CAPITAL ASSETS**

Capital Assets activities for the fiscal year ended June 30, 2013 was as follows:

<b>Governmental Activities</b>	<b>Balance July 1, 2012</b>	<b>Additions</b>	<b>Retirements</b>	<b>Balance June 30, 2013</b>
Capital Assets not being Depreciated:				
Land	\$ 42,356,505	\$ 519,800	\$ -	\$ 42,876,305
Construction in Progress		1,472,827		1,472,827
Non Depreciable Assets	765,615			765,615
<b>Total Capital Assets not being depreciated</b>	<b>\$ 43,122,120</b>	<b>1,992,627</b>	<b>-</b>	<b>\$ 45,114,747</b>
Capital Assets being depreciated:				
Building	44,457,881	1,842,068		46,299,949
Infrastructure	41,310,246	4,261,104		45,571,350
Motor Vehicles	3,908,425			3,908,425
Equipment	5,479,365	339,755		5,819,120
<b>Total Depreciable Capital Assets</b>	<b>95,155,917</b>	<b>6,442,927</b>		<b>\$101,598,844</b>
Less Accumulated Depreciation:				
Building	\$ 15,616,088	\$ 677,995		\$ 16,294,083
Infrastructure	19,958,111	325,545		20,283,656
Equipment	4,955,794	189,997		5,145,791
Motor Vehicles	3,425,188	300,723		3,725,911
<b>Total Accumulated Depreciation</b>	<b>43,955,181</b>	<b>1,494,260</b>		<b>45,449,441</b>
<b>Total Capital Assets being depreciated, net</b>	<b>51,200,736</b>	<b>4,948,667</b>		<b>56,149,403</b>
<b>Governmental Activities Capital Assets, net</b>	<b>\$ 94,322,856</b>	<b>\$ 6,941,294</b>		<b>\$101,264,150</b>

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

General Government	\$ 677,995
Public Safety	80,000
Public Works	400,720
Culture and Recreation	206,540
Urban Development	129,005
<b>Depreciation Expense</b>	<b>\$1,494,260</b>

**11. GENERAL LONG-TERM DEBTS**

**A. General Obligations Bonds**

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund. The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy sent to the Municipality.

General obligations bonds and notes payable as of June 30, 2013, are comprised of the following individual issues:

<u>DESCRIPTION</u>	<u>AMOUNT</u>
<b>General Obligations Bonds:</b>	
\$11,435,000, Series 1999-1998, for construction purposes, payable in annual installments ranging from \$305,000 to \$1,130,000, excluding variable interests from 4.81% to 6.34% until July 1, 2016	\$ 4,040,000
\$14,440,000, Series 2006-2007 for construction purposes, payable in annual installments ranging from \$279,000 to \$1,289,000, excluding variable interests from 0.47% to 7.00%, until July, 2031	12,779,000
\$370,000 Series 1994-1995, for construction purposes, payable in annual installments ranging from \$5,000 to \$35,000, excluding variable interests from 6.106% to 8.21%, until July 1, 2019.	185,000
\$21,490,000 Series 2011-2012, for construction purposes, payable in annual installments ranging from \$915,000 to \$2,355,000, excluding variable interests from 3.44% to 7.50%, until July 1, 2025.	20,575,000
\$2,045,000 Series for construction purposes, payable in annual installments ranging from \$230,000 to \$360,000, excluding variable interests from 3.44% to 7.50%, until July 1, 2018.	<u>1,815,000</u>
<b>Total General Obligations Bonds</b>	<b><u>\$39,394,000</u></b>

The Municipality's general obligations long-term note retirements are appropriated and paid from resources accumulated in the Debt Service Fund. The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy sent to the Municipality.

continue

**11. GENERAL LONG-TERM DEBTS – continuation**

Annual maturity requirements for the bonds and notes payable and loan guarantee assistance notes are as follows:

<u>Bond Payables</u>	<u>Principal</u>	<u>Interest</u>
2014	\$ 2,536,000	\$ 1,881,335
2015	2,726,000	1,836,982
2016	2,913,000	2,373,129
2017	3,124,000	2,261,634
2018	2,129,000	1,973,188
2019-2023	11,517,000	7,398,589
2024-2028	10,340,000	2,887,155
2029-2033	<u>4,109,000</u>	<u>617,925</u>
<b>Total</b>	<b><u>\$39,394,000</u></b>	<b><u>\$21,229,937</u></b>

**B. Advances from the Municipal Revenue Collection Center (MRCC)**

These Amounts represent the balance owed to CRIM at June 30, 2013 as described in Note 13 and that will be repaid through financing to be obtained by the CRIM.

<u>Advances From MRCC</u>	<u>Principal</u>	<u>Interest</u>
2014	\$ 5,378	\$ 12,000
2015	5,715	11,663
2016	6,075	11,303
2017	6,456	10,922
2018	6,862	10,516
2019-2023	41,347	45,544
2024-2028	56,076	30,817
2029-2033	<u>67,360</u>	<u>10,844</u>
	<b><u>\$195,269</u></b>	<b><u>\$143,609</u></b>

continue

11. GENERAL LONG-TERM DEBTS – continuation

C. Changes in General Long-term Debts

<i>Description</i>	<i>Balance July 01, 2012</i>	<i>New Issues</i>	<i>Retirements and Adjustments</i>	<i>Balance June 30, 2013</i>	<i>Amount Due Within One Year</i>	<i>Amount due After Next Year</i>
General.....	\$41,747,000	\$ -	(\$ 2,353,000)	\$39,394,000	\$ 2,536,000	\$36,858,000
Christmas Bonus.....	275,974	333,864	(275,974)	333,864	333,864	-
Property Taxes.....	200,329	-	(5,060)	195,269	5,378	189,891
Compensated Absences.....	1,818,818	1,072,640	(414,458)	2,477,000	570,637	1,906,363
	\$44,042,121	\$1,406,504	\$ (3,048,492)	\$42,400,133	\$3,445,879	\$38,954,254

D. Legal Debt and Legal Debt Margin

On March 9, 2009, the Commonwealth of Puerto Rico approves Law Number 7 that provides for revision of the valuation of property subject to taxation and imposes special property taxes for the Commonwealth. The Municipality debt limits are 10% of valuation of property subject to taxation, plus the balance of the special ad valorem taxes in the Debt Service Fund. In addition, before any new bonds are issued, the revenues of the Debt Service Fund should be sufficient to cover the projected debt service requirement. Additional legal debt margin was determine for the issuance of the special obligations bonds that are paid through retention made by the MRCC from monthly advance of annual property tax and subsidy send to the Municipality.

12. DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality (See Note 13).

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

13. 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 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 9.40% for real property and 7.40% for personal property. The composition is as follows:

Basic property	6.00%	4.10%	4.10%
Additional special property - state		1.03%	1.03%
Additional special property - municipal		3.10%	4.67%
Discounts made by state to tax payer		<.20%>	<.20%>
		<u>8.43%</u>	<u>7.40%</u>

continue

### 13. PROPERTY TAXES – continuation

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.

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 end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. The advances from CRIM as of June 30, 2013, are presented as non-current liabilities in the government-wide financial statements.

### 14. VOLUME OF BUSINESS TAX

Volume of Business Tax is recorded in the fiscal year in which payment is due and, accordingly, represents taxes which are due and uncollected at June 30, 2013. The Volume of Business Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of Fajardo, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

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 23. The rates of municipal license in the Municipality of Fajardo, are as follows:

Financing institution = 1.50% of gross revenues  
Other organizations = .50%

The sales tax revenue will be affected for FY 14-15, Law Number 18, effective on July 1, 2014. This law created a corporation called "COFIM" to manage municipal taxes (1%) in an account bank in the BGF, revenues will be received during the first 10 days of the following month based on income received in the previous year.

continue

## 15. INTERGOVERNMENTAL REVENUES

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

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

## 16. EMPLOYEE'S RETIREMENT PLAN

### *Defined Benefit Plan*

The Government of Puerto Rico Employees Retirement System (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of, the Commonwealth of Puerto Rico (the Commonwealth). All regular employees of the Municipality under the age of 55 at the date of employment become members of the ERS as a consequence of their employment.

The ERS provides retirement, death, and disability benefits pursuant to Act No. 447, approved on May 15, 1951, as amended, which became effective on January 1, 1952. Disability retirement benefits for occupational and non-occupational disabilities are available to members enrolled in the plan before January 1, 2000. Benefits vest after ten years of plan participation. The amount of the annuity shall be one and one half percent (1.5%) of the average compensation multiplied by the number of years of creditable service up to twenty (20) years, plus two percent (2%) of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case shall the annuity be less than \$200 per month.

Participants who have completed at least thirty years of creditable service are entitled to receive a Merit Annuity. Such participants who have not attained fifty-five years of age will receive 65% of the average compensation or if they have attained fifty-five 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 years of service. No benefits are payable if participants receive a refund of their accumulated contributions.

Commonwealth legislation requires that employees hired before April 1, 1990 contribute 5.775% of the first \$550 of their monthly gross salary and 8.275% of their gross monthly salary in excess of \$550. Employees hired after April 1, 1990 contribute 8.275% of their gross monthly salary. The Lottery's contributions are 11.275% of the gross monthly salary.

### *Defined Contribution Plan*

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the ERS, was enacted for the purpose of establishing a new pension program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the ERS as of December 31, 1999 had the option to stay in the defined benefit plan or transfer to System 2000. Employees joining the Administration on or after January 1, 2000 are only allowed to become members of System 2000.

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

continue

**16. EMPLOYEE'S RETIREMENT PLAN – continuation**

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000.

Furthermore, on April 4, 2013, the Governor of Puerto Rico signed into Act No. 3 of 2013, which represents a comprehensive reform of the ERS. Act No. 3 became effective on July 1, 2013 and amends the provisions of the different benefits structures under the ERS, including, but not limited to, the following:

- For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter, all future benefits will accrue under the defined contribution formula used for System 2000 participants, and will be paid at retirement through a lifetime annuity.
- Increases the minimum pension for current retirees from \$400 to \$500 per month.
- The retirement age for Act No. 447 participants will be gradually increased from age 58 to age 61.
- The retirement age for current System 2000 participants is increased gradually from age 60 to age 65.
- Eliminates the “merit annuity” available to participants who joined the ERS prior to April 1, 1990.
- The retirement age for new employees is increased to age 67, except for new state and municipal police officers, firefighters, and custody officers, which will be age 58.
- The employee contribution rate will increase from 8.275% to 10%.
- For System 2000 participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.
- Eliminates or reduces various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus payable to current retirees is reduced from \$600 to \$200 and is eliminated for future retirees. The summer bonus will be eliminated.
- Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.
- Survivor benefits will be modified.
- The Municipality’s contributions will increase gradually effective July 1, 2013. The required contribution for fiscal year ending June 30, 2014 will be 12.275%. Subsequently the required contribution will increase by 1% every year up to July 1, 2016 when the annual increase will be 1.25% up to a total contribution of 20.525%.

During the year ended June 30, 2013, the Municipality contributions to this plan amounted to approximately \$347,042. These amounts represented the 100% of the required contribution for the corresponding year. Additionally, changes made in the types and amounts of benefits offered by special laws and costs of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2013 a copy of which can be obtained from the Administrator of the Retirement System: P.O. Box 42003, San Juan, Puerto Rico 00940.

## 17. HEALTHCARE COSTS

During the year ended June 30, 2000 the Governor of the Commonwealth of Puerto Rico required to the municipalities of Puerto Rico an annual contribution to subsidy the cost of the implementation and administration of the Healthcare Reform. Such contributions are required to be disbursed from general fund operating budget. Total contributions made by the Municipality amounted to approximately \$1,021,209 for the fiscal year ended June 30, 2013.

## 18. ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS

State and Federal laws and regulations require the Municipality to place a final cover on its landfill when closed and perform certain maintenance and monitoring function at the landfill site for thirty years after closure. In addition to the operating expenditures related to current activities of the landfill, an expense provision and related liability are being recognized based on futures closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste.

The Municipality owns a landfill, which is administered by Landfill Technologies under an agreement with the Municipality. The Municipality is entitled, under the agreement, to certain revenues resulting from the use of the landfill. As part of the agreement the contractor will assume the closure and post-closure costs during the next thirty years after the closing, releasing the Municipality of the estimated liability for future closure and post-closure care cost.

## 19. CONTINGENCIES

### A. Claims and Judgments

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. The legal counsel of the Municipality has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available cannot determine the final outcome of these claims.

### B. Federal Grants

In the normal course of operations, the Municipality receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. The legal counsels of the Municipality have advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

## 20. SALES AND USAGE TAXES

Municipality impose a Sales and Usage Taxes of 1.5% (1.0%) collected and belong to the Municipality and 0.5% collected by the Puerto Rico Secretary of the Treasury) on the sales price of a taxable item or the purchase price of all usage, storage or consumption of a taxable item. All merchants required to collect the Sales and Usage Taxes, are required to file a monthly Sales and Use Tax Return Form, no later than the 10<sup>th</sup> of the following month being reported. The Act also provides for restrictions on the use of the resources (including the 0.5% collected by the Puerto Rico Secretary of Treasury) to be invested in solid waste and recycling program, capital improvements and health and public safety costs.

continue

## 20. SALES AND USAGE TAXES – continuation

The amount collected by the Puerto Rico Secretary of Treasury will be deposited in accounts or special fund GDB, subject to restrictions imposed and distributed as follows:

- a. 0.2% will be deposited in a Municipal Development Fund to finance costs as Restricted by the Act;
- b. 0.2% will be deposited in a Municipal Redemption Fund to finance loans Municipalities subject to restrictions imposed the a Act; and
- c. 0.1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects. These funds will be distributed based on legislation from the Commonwealths Legislature.

Sales tax receivable represents filed sales tax returns that were collected subsequent to June 30, 2013, but pertaining to the current year period.

## 21. CONSTRUCTION EXCISE TAXES

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

The construction excise tax generally is a self-assessed tax imposed over the cost the project, net of certain exemptions such as the cost associated with the acquisition of land, existing buildings and improvements, project design and other engineering fees, licenses and permits, consulting and legal fees. The tax is paid by the taxpayer before the beginning of the construction project.

Any construction, which doesn't qualify for any of the exceptions presented below, will pay a tax of 4% of the total cost amount of the project. The exceptions for the 4% Construction Tax imposed by the Municipality are as follow:

- a. 5.00% of the total cost of the project for any construction involving of land.
- b. 2.00% for all low income housing project, and educational institutions of primary and second level.
- c. When construction is for a residence, made of at least 50% concrete, and said Residence is no part of a housing project, urbanization, condominium, or any project of similar nature; a fixed rate of \$25.00 will be collected up to a maximum total construction cost of \$ 50,000. In addition, for every \$ 1,000 in excess of the \$ 50,000 in total construction cost, \$ 5.00 rates will Taxes are payable before beginning construction or any activity related to the construction. Collection of taxes during current fiscal year, applicable to the next fiscal year, is recorded as deferred revenues in the General Fund.

continue

**22. FUND BALANCES**

As of June 30, 2013, a fund balance is compromised of the following:

	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	LOAN 21,490,000 FUND	ARTS CENTER FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Nonexpendable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Restricted For:								
Debt Service	-	-	-	-	-	20,937,120	-	20,937,120
Public Works	-	-	4,288,913	-	-	-	-	4,288,913
Capital Outlays	-	-	-	16,507,342	8,003,660	-	14,926,332	39,437,334
<b>Total Restricted</b>	<b>-</b>	<b>-</b>	<b>4,288,913</b>	<b>16,507,342</b>	<b>8,003,660</b>	<b>20,937,120</b>	<b>14,926,332</b>	<b>64,663,367</b>
Committed To:								
Capital Outlays	-	-	-	-	-	-	6,569,354	6,569,354
<b>Total Committed</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,569,354</b>	<b>6,569,354</b>
Assigned To:								
General Government	268,732	-	-	-	-	-	-	268,732
Public Safety	5,508	-	-	-	-	-	-	5,508
Public Works	9,031	-	-	-	-	-	-	9,031
Recreation	11,944	-	-	-	-	-	-	11,944
Health and Welfare	2,034	-	-	-	-	-	-	2,034
<b>Total Assigned</b>	<b>297,249</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>297,249</b>
Unassigned	12,890,804	-	-	-	-	-	-	12,890,804
<b>Total Fund Balances</b>	<b>\$ 13,188,053</b>	<b>\$ -</b>	<b>\$ 4,288,913</b>	<b>\$ 16,507,342</b>	<b>\$ 8,003,660</b>	<b>\$ 20,937,120</b>	<b>\$ 21,495,686</b>	<b>\$ 84,420,774</b>

**23. NET POSITION/FUND BALANCES RESTATEMENTS**

**A. Net Position**

The following reconciles the June 30, 2012 Net Position, as previously reported to Beginning Net Position, as restated, July 1, 2012 for the various funds:

	Governmental Activities
<b>Net Position, as Previously Reported, At June 30, 2012</b>	<b>\$ 144,333,015</b>
Adjustment to Fund Balances	3,744,568
Adjustment to Long Term Debts	2,353,000
Adjustment to Revenue Overstated	(1,156,139)
Adjustment Unavailable Revenue - Head Start Program	(903,817)
Adjustment Unavailable Revenue - CDBG Program	(33,644)
<b>Beginning Net Position, as Restated, At July 1, 2012</b>	<b>\$ 148,336,983</b>

continue

**23. NET POSITION/FUND BALANCES RESTATEMENTS**

**B. Fund Balances**

The following reconciles the June 30, 2012 Fund Balance, as previously reported to Beginning Fund Balance, as restated, July 1, 2012 for the various funds:

	General Fund	Head Start Fund	Sales and Usage Taxes Fund	Loan \$21,400,000 Fund	Art Center Fund	Debt Service Fund	Other Governmental Funds
<b>Fund Balance, As Previously Reported, At June 30, 2012</b>	\$ 17,821,689	\$ 335,738	\$ 4,341,140	\$ 20,310,086	\$ 8,853,170	\$ 18,784,635	\$ 16,278,716
Interfund Balance	-	-	-	-	-	-	4,721,729
Overstatement of Revenues	(1,432,239)	(137,796)	-	(16,098)	-	(126,474)	-
Understatement of Revenues	-	-	-	-	-	-	645,971
Understatement of Expenditures	-	-	-	-	(840,510)	-	-
Overstatement of Expenditures	-	-	-	-	-	-	863,472
Cash	66,513	-	-	-	-	-	-
<b>Fund Balance, As Restated, At July 1, 2012</b>	<u>\$ 16,455,963</u>	<u>\$ 197,942</u>	<u>\$ 4,341,140</u>	<u>\$ 20,293,988</u>	<u>\$ 8,012,660</u>	<u>\$ 18,658,161</u>	<u>\$ 22,509,888</u>

**24. NEW ACCOUNTING STANDARDS**

The GASB has issued Statement 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. GASB 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that are included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the American Institute of Certified Public Accountants (AICPA) Committee on Accounting Procedure. GASB 62 does not have any impact on the Municipality's financial statements.

The Municipality adopted GASB Statement No. 63, *Financial Reporting of Deferred outflows of Resources, Deferred Inflows of Resources, and Net Position* as of June 30, 2013, which changed the Statement of Net Assets to the Statement of Net Position and provides guidance for reporting deferred outflows and inflows of resources. The adoption of this standard did not have any financial impact on the financial statements.

GASB Statement No. 64 ("GASB 64") Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53 was issued in June 2011. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The requirements of Statement No. 64 are effective for financial statements for periods beginning after June 15, 2011 and were adopted the Municipality effective July 1, 2012 with no significant impact on the financial statements.

Also, the Municipality adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* as of June 30, 2013, which establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as revenues and expenses. The adoption of this statement require that debt issuance costs be recognized as an expenses in the period incurred.

## 25. SUBSEQUENT EVENTS

As per Act Number 18 of 2014 was created the "Law of Municipal Administration Fund (MAF)" to establish a special fund called the Municipal Administration, authorize municipalities to pledge the funds deposited in the Local Government Fund to which they are to secure the repayment of any loan, bond, note or other evidence of indebtedness, which are the source of repayment funds deposited in the Special Fund and to meet any expenditure budget of the municipality and the municipality any activity or project, authorize the Government Development Bank for Puerto Rico to make disbursements for purposes set out in this Act.

This measure is intended, first, to strengthen the financial capacity of the Corporation Tax Fund of Puerto Rico (COFINA, by Spanish acronyms), established under Law No. 91-2006, as amended, known as the "Law Fund of Sales and Usage Taxes", adjusting the sales and usage taxes (SUT) by increasing the state portion to 6.0% while the municipal SUT is reduced to 1.0%, effective February 1, 2014.

Through this legislation a mechanism under which the SUT collections entitled to receive the Commonwealth of Puerto Rico each fiscal year, after complying with the deposits in the Tax Fund requires by Act No. 91-2006, shall be deposited in a special fund created for the benefit of, and assigned to the municipalities. This special fund is called the "Local Government Fund" ("LGF"), which will be guarded by the Government Development Bank of Puerto Rico.

Also, on February 1, 2014 was enacted the Act No. 19 that creates the Municipal Financing Corporation (COFIM, by Spanish acronyms). The COFIM, attached to the Government Development Bank (GDB), with the power to issue bonds or use other mechanisms to pay or refinance debt incurred by municipalities, the payment of principal and interest is backed by the municipal SUT.

In addition, create the Redemption Fund of COFIM, to which the resources of the existing Municipal Fund Redemption will be transferred effective February 1, 2014, and facilitated the distribution of funds from the Municipal Redemption Fund, the Municipal Development Fund and the Municipal Improvement Fund. Provides that the first proceeds of the municipal SUT of 1% shall be collected by the Treasury Department and deposited directly into the Redemption Fund of COFIM. Provides that bonds and notes issued by the COFIM be payable and secured by the pledge of a fixed amount, or municipal SUT corresponding to a fixed rate of 0.3% has been collected during the previous fiscal year, whichever is greater.

In preparing these financial statements the Municipality has evaluated events and transaction for potential recognition or disclosure through May 29, 2014, the date the financial statements were available to be issued.

## END OF NOTES

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**REQUIRED SUPPLEMENTARY INFORMATION**

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COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO

REQUIRED SUPPLEMENTARY INFORMATION  
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Accompanying Notes)	Variance with Final Budget
	Original	Final		
<b>BUDGETARY FUND BALANCE, JULY 1, 2012</b>	<b>\$ 16,731,937</b>	<b>\$ 16,731,937</b>	<b>\$ 16,731,937</b>	<b>\$ -</b>
Resources (Inflows):				
Property Taxes	8,294,064	8,294,064	8,294,066	2
Volume of Business Taxes	8,290,000	8,290,000	7,534,909	(755,091)
Intergovernmental	4,615,231	4,615,231	4,594,585	(20,646)
Construction Excise Taxes	1,515,500	1,515,500	1,717,101	201,601
Rent	220,660	220,660	336,328	115,668
Miscellaneous	708,639	708,639	1,326,315	617,676
<b>Total Resources (Inflows)</b>	<b>23,644,094</b>	<b>23,644,094</b>	<b>23,803,304</b>	<b>159,210</b>
Amounts Available for Appropriation	40,376,031	40,376,031	40,535,241	159,210
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	3,267,251	3,775,251	2,917,585	857,666
General Government	8,316,341	9,030,892	7,679,274	1,351,618
Public Safety	1,493,564	1,509,049	916,541	592,508
Public Works	1,956,866	2,425,690	1,758,105	667,585
Culture and Recreation	1,329,617	1,619,178	1,351,178	268,000
Health and Sanitation	5,394,280	5,398,280	3,496,016	1,902,264
Human Services and Welfare	1,472,981	1,494,876	908,292	586,584
Capital Outlays	413,194	416,194	348,678	67,516
Transfers to Other Funds	-	7,940,568	7,940,568	-
Total Charges to Appropriations	23,644,094	33,609,978	27,316,237	6,293,741
<b>BUDGETARY FUND BALANCE, JUNE 30, 2013</b>	<b>\$ 16,731,937</b>	<b>\$ 6,766,053</b>	<b>\$ 13,219,004</b>	<b>\$ 6,452,951</b>

The accompanying Notes to Required Supplementary Information are an integral part of this schedule.

**1. BUDGETARY REPORTING**

The Budgetary Comparison Schedule – General Fund is presented as Required Supplementary Information in accordance with GASB Accounting Standard Codification Section 1700, *The Budget and Budgetary Accounting*. Formal and legal budgetary control is based upon major classes of expenditures known as functions.

**2. EXPLANATION OF DIFFERENCES BETWEEN BUDGETARY INFLOWS AND OUTFLOW AND GAAP REVENUES AND EXPENDITURES**

	<u>General Fund</u>
<b>Sources/Inflows of Resources:</b>	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 55)	\$ 40,535,241
Difference – Budget to GAAP:	
The Fund Balance (Deficit) at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes	<u>(16,731,937)</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 23)	<u>\$ 23,803,304</u>
<b>Uses/Outflows of Resources:</b>	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 55)	\$ 27,316,237
Difference – Budget to GAAP:	
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes	(297,249)
Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes	52,226
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	<u>(7,940,568)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 23)	<u>\$ 19,130,646</u>

**END OF THIS SECTION**

**SUPPLEMENTARY INFORMATION REQUIRED BY  
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

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<u>Line Ited No.</u>		<u>Value</u>
	<b>Assets</b>	
	<b>Current Assets - Cash:</b>	
111	Cash - Unrestricted	\$257,593
113	Cash - Other Restricted	<u>2,445</u>
<b>100</b>	<b>Total Cash</b>	<b><u>260,038</u></b>
<b>150</b>	<b>Total Current Assets</b>	<b><u>260,038</u></b>
<b>190</b>	<b>Total Assets</b>	<b><u>\$260,038</u></b>
	 <b>Liabilities and Equity</b>	
	<b>Current Liabilities:</b>	
312	Accounts Payable <= 90 Days	\$ 2,381
333	Accounts Payable - Other Government	<u>13,134</u>
<b>310</b>	<b>Total Current Liabilities</b>	<b><u>15,515</u></b>
<b>300</b>	<b>Total Liabilities</b>	<b><u>15,515</u></b>
	 <b>Equity:</b>	
511.1	Restricted Net Position	2,445
512.1	Unrestricted Net Position	<u>242,078</u>
<b>513</b>	<b>Total Equity / Net Position</b>	<b><u>244,523</u></b>
<b>600</b>	<b>Total Liabilities and Equity / Net Position</b>	<b><u>\$260,038</u></b>

The accompanying Notes to Financial Data Schedule are an integral part of this Supplementary Information.

<u>Line Ited No.</u>		<u>Value</u>
<b><u>Revenues</u></b>		
70600	HUD PHA Operating Grants	\$452,052
71100	Investment Income - Unrestricted	905
71400	Fraud Recovery	1,792
71500	Other Revenue	<u>83,035</u>
<b>70000</b>	<b>Total Revenues</b>	<b><u>537,784</u></b>
<b><u>Expenses</u></b>		
<b>Administrative:</b>		
91100	Administrative Salaries	34,209
91500	Employee Benefit Contributions - Administrative	6,504
91600	Office Expense	2,825
91900	Other	<u>2,698</u>
<b>91000</b>	<b>Total Operating - Administrative</b>	<b><u>46,236</u></b>
<b>Utilities</b>		
93800	Other Utilities Expense	<u>3,055</u>
<b>93000</b>	<b>Total Utilities</b>	<b><u>3,055</u></b>
<b>96900</b>	<b>Total Operating Expenses</b>	<b><u>49,291</u></b>
<b>Excess of Operating Revenue over</b>		
<b>97000</b>	<b>Operating Expenses</b>	<b><u>488,493</u></b>
97300	Housing Assitance Payments	461,194
97350	HPA Portability-In	<u>78,093</u>
<b>90000</b>	<b>Total Expenses</b>	<b><u>588,578</u></b>
<b>Excess (Deficiency) of Total Revenue over</b>		
<b>10000</b>	<b>(under) Total Expenses</b>	<b><u>\$ (50,794)</u></b>
<b>Memo Account Information:</b>		
*110030	Beginning Equity	\$194,317
*110040	Prior Period Adjustments, Equity Transfers and Correction of Errors	\$101,000
*11170	Administrative Fee Equity	\$242,078
*11180	Housing Assistance Payments Equity	\$ 2,445
*11190	Unit Months Available	948
*11210	Number of Unit Months Leased	889

The accompanying Notes to Financial Data Schedule are an integral part of this Supplementary Information.

**1. BASIS OF PRESENTATION**

The accompanying Financial Data Schedule (FDS) includes the Section 8 Housing Choice Vouchers Program activities of the Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico (Municipality). The information in the FDS is presented in accordance with the requirements of *HUD's Uniform Financial Reporting Standards for HUD Housing Programs*. Because the FDS presents only a selected portion of the operations of Municipality, it is not intended to and does not present the financial position, or change in net assets of the Municipality.

Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The Municipality reporting entity is defined in Note (1) (A) to the basic financial statements.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Assets, Liabilities, Net Position, Revenues and Expenses reported on the FDS, are reported on the full accrual basis of accounting. They are recognized following the *HUD's Uniform Financial Reporting Standards for HUD Housing Programs*.

**3. RELATIONSHIP TO BASIC FINANCIAL STATEMENTS**

Assets, Liabilities and Net Position are presented in the Municipality's Statement of Net Position. Revenues and Expenses are reported in the Statement of Activities.

**END OF NOTES**

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**PART II**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
AND REPORTS REQUIRED BY GOVERNMENT AUDITING  
STANDARDS AND OMB CIRCULAR A-133**

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COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through Puerto Rico Department of Education:			
Child and Adult Care Food Program .....	10.558	N/AV	\$ <u>415,823</u>
Total U. S. Department of Agriculture .....			<u>415,823</u>
U.S. Department of Housing and Urban Development:			
Direct Program:			
Community Development Block Grant/ Entitlements Grants (CDBG).....	14.218		1,033,769
Section 8 Housing Choice Vouchers Program.....	14.871		<u>588,578</u>
Total Direct Programs .....			<u>1,622,347</u>
Pass-Through Autonomous Municipality of San Juan of the Commonwealth of Puerto Rico:			
Housing Opportunities for Person with AIDS (HOPWA) ...	14.241	6628-13-30131600-2058	26,425
Pass-Through Puerto Rico Family Department:			
<b>ARRA</b> – Homelessness Prevention and Rapid Re-Housing Program .....	14.257	N/AV	<u>56,711</u>
Total U.S. Department of Housing and Urban Development.....			<u>1,705,483</u>
U. S. Department of Justice:			
Pass-Through Puerto Rico Department of Justice:			
Edward Byrne Memorial Justice Assistance Grant Program .....	16.738		<u>62,856</u>
Total U.S. Department of Transportation .....			<u>62,856</u>
U. S. Department of Transportation:			
Federal Transit Formula Grants.....	20.507		<u>73,600</u>
Total U.S. Department of Transportation .....			<u>73,600</u>

**COMMONWEALTH OF PUERTO RICO  
AUTONOMOUS MUNICIPALITY OF FAJARDO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Health and Human Services:			
Pass-Through Administration for the Childhood Care and Integral Development:			
Child Care and Development Block Grant .....	93.575	241-2013-000169	49,294
Head Start Program .....	93.600	241-2013-000197	<u>4,982,824</u>
Total U.S. Department of Health and Human Services ..			<u>5,032,118</u>
U.S. Department of Homeland Security:			
Pass-Through Puerto Rico Office of Disaster and Emergencies Administration:			
Disaster Grants – Public Assistance (Presidential Declared Disasters) .....	97.036	N/AV	173,629
Pass-Through Puerto Rico Office for Public Security:			
Homeland Security Grant Program .....	97.067	2010-SS-TO-0093	<u>54,320</u>
Total U. S. Department of Homeland Security .....			<u>227,949</u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS .....</b>			<b><u>\$7,517,829</u></b>

The accompanying Notes to Schedule of Expenditures of Federal Awards are an integral part of this schedule.

**1. BASIS OF PRESENTATION**

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activities of the Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico (Municipality). The information in this Schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of Municipality, it is not intended to and does not present the financial position, or change in net assets of the Municipality.

Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The Municipality reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed-through other government agencies are included on the Schedule.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- A. Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State and Local Government*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.
- B. Negative amounts, if any, shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.
- C. Pass-through entity identifying numbers are presented where available.

**3. FEDERAL CFDA NUMBER**

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

**4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Expenditures of federal awards are reported in the Municipality's Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Fund as follows: Head Start Fund – \$5,385,783 and Other Governmental Funds \$2,132,046.

**END OF NOTES**

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**INDEPENDENT AUDITOR'S 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  
Member of the Municipal Legislature  
Autonomous Municipality of Fajardo of the  
Commonwealth of Puerto Rico**

We have audited, in accordance with the 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, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise **Municipality's** basic financial statements, and have issued our qualified report thereon dated May 29, 2014. Our report was qualified because the **Municipality** did not provide a subsidiary of capital assets that agreed with the amounts reported in governmental activities of the Governmental-Wide Financial Statements and, also, the depreciation expense on those assets is not supported.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered **Municipality's** internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **Municipality's** internal control. Accordingly, we do not express an opinion on the effectiveness of **Municipality's** internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weakness or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the **Municipality's** financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as items 2013-001 through 2013-005 to be material weaknesses.

**INDEPENDENT AUDITOR'S 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  
Member of the Municipal Legislature  
Autonomous Municipality of Fajardo of the  
Commonwealth of Puerto Rico

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**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the **Municipality's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed 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 2013-003 through 2013-005.

**Municipality's Response to Findings**

**Municipality's** response to the findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. **Municipality's** response was not subjected to the auditing procedures applied in the audit of the financial statement and, accordingly, we express no opinion on it.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the **Municipality's** internal control or on compliance. This report is an integral part of an audit reformed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



CPA Díaz-Martínez, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2016

Caguas, Puerto Rico  
May 29, 2014

Stamp No. E100053 was affixed to  
the original report.



## INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE REQUIREMENTS FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Honorable Mayor and  
Member of the Municipal Legislature  
Autonomous Municipality of Fajardo of the  
Commonwealth of Puerto Rico

### Report on Compliance for Each Major Federal Program

We have audited **Autonomous Municipality of Fajardo of the Commonwealth of Puerto Rico (Municipality)**'s compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of **Municipality**'s major federal programs for the fiscal year ended June 30, 2013. **Municipality**'s major federal programs are identified in the Summary of Auditors' Result Section of the accompanying Schedule of Findings and Questioned Costs.

### **Management's Responsibility**

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on compliance for each of **Municipality**'s major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about **Municipality**'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of **Municipality**'s compliance.

### **Basis for Qualified Opinion (See the following Table)**

As described in the accompanying Schedule of Findings and Questioned Costs, **Municipality** did not comply with requirement regarding the following:

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE REQUIREMENTS FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Honorable Mayor and  
Members of the Municipal Legislature  
Autonomous Municipality of Fajardo of the  
Commonwealth of Puerto Rico

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<b>Finding Number</b>	<b>CFDA Number</b>	<b>Program (or Cluster) Name</b>	<b>Compliance Requirement</b>
2013-006	ALL	ALL PROGRAMS	Reporting
2013-007	ALL	ALL PROGRAMS	Reporting
2013-008	14.871	Section 8 Choice Vouchers Program	Reporting

Compliance with such requirements is necessary, in our opinion, for the **Municipality** to comply with the requirements applicable to those programs.

**Qualified Opinion (See the above Table)**

In our opinion, except for the noncompliance described in the “Basis for Qualified Opinion” paragraph, **Municipality** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the major federal programs described in the above table for the fiscal year ended June 30, 2013.

**Other Matters**

**Municipality's** response to the noncompliance finding identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. **Municipality's** response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

**Report on Internal Control Over Compliance**

Management of **Municipality** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered **Municipality's** internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 **Municipality's** internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE REQUIREMENTS FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

**To the Honorable Mayor and  
Members of the Municipal Legislature  
Autonomous Municipality of Fajardo of the  
Commonwealth of Puerto Rico**

Page 3

*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 2013-006 through 2013-008 to be material weaknesses.

**Municipality's** response to the internal control over compliance finding identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. **Municipality's** response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.



CPA Díaz-Martínez, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2016

Caguas, Puerto Rico  
May 29, 2014

Stamp No. E100054 was affixed to  
the original report.

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**PART III**  
**FINDINGS AND QUESTIONED COSTS**

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SECTION I – SUMMARY OF AUDITOR’S RESULTS

**Financial Statements**

Type of auditors’ report issued:  Unmodified Opinion  
 Modified:  Qualified Opinion  
 Adverse Opinion  
 Disclaimer Opinion

Internal control over financial reporting:

- Material weakness (es) identified?  Yes  No
- Significant deficiency (ies) identified?  Yes  None Reported
- Noncompliance material to financial statements noted?  Yes  No

**Federal Awards**

Internal control over major programs:

- Material weakness (es) identified?  Yes  No
- Significant deficiency (ies) identified?  Yes  None Reported

Type of auditor’s report issued on compliance for Major Programs:

- Unmodified Opinion  
 Qualified Opinion
- Child and Adult Food Program
  - Community Development Block Grants/Entitlements Grants
  - Section 8 Housing Choice Vouchers Program
  - Head Start Program
- Adverse Opinion  Disclaimer Opinion

Any audit findings disclosed that are required to be reported in accordance with Section 510 (a) of OMB Circular A-133?

Yes  No

Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
10.558	Child and Adult Care Food Program
14.218	Community Development Block Grant/Entitlements Grants
14.871	Section 8 Housing Choice Vouchers Program
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B Programs:

\$300,000

Auditee qualified as low-risk auditee?

Yes  No

SECTION II – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER 2013-001

TYPE OF FINDING MATERIAL WEAKNESS IN PREPARED FINANCIAL STATEMENTS

CRITERIA AU Section 325, *Communicating Internal Control Related Matters Identified in an Audit*, paragraph .15, states the follows:

Indicators of material weaknesses in internal control include

...

- restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud;

...

Paragraph 4.23, *Communicating Deficiencies in Internal Control, Fraud, Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements, and Abuse*, of the Government Auditing Standards states the follows:

**4.23** When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; ...

Paragraph 4.24, *Deficiencies in Internal Control*, of the Government Auditing Standards states the follows:

**4.24** The AICPA requirements to communicate in writing significant deficiencies and material weaknesses identified during an audit form the basis for reporting significant deficiencies and material weaknesses in the GAGAS report on internal control over financial reporting when deficiencies are identified during the audit.

Appendix I, *Supplemental Guidance*, paragraph A.06, *Examples of Deficiencies in Internal Control*, of the Government Auditing Standards states the follows:

**A.06** The following are examples of control deficiencies:

a. ...

b. ...

c. Control systems that did not prevent, or detect and correct material misstatements so that it was necessary to restate previously issued financial statements or operational results. Control systems that did not prevent or detect material misstatements in performance or operational results so that it was later necessary to make significant corrections to those results.

d. Control systems that did not prevent, or detect and correct material misstatements identified by the auditor. This includes misstatements involving estimation and judgment for which the auditor identifies potential material adjustments and corrections of the recorded amounts.

CONDITION

During the preparation of the financial statements by the **Municipality**, we noted material misstatements in prior year audited financial statements that required significant adjustments to fund balances/net position. In addition, during our audit of this year financial statements, significant adjustments were proposed to adjust assets, liabilities, revenues, interfund transactions.

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2013-001 – continuation
<b>CAUSE</b>	The <b>Municipality's</b> internal control system, failed to obtain assurance of transactions that affect the financial statements. In addition, the <b>Municipality</b> accounting system does not provide for some mechanized transaction that could lead to errors if proper trace is not maintained.
<b>EFFECT OR POSSIBLE EFFECT</b>	The financial statements for the fiscal year ended June 30, 2013, prepared by the <b>Municipality</b> presented material misstatements related to the beginning balance of the net position/fund balance, and in their assets, liabilities, revenues, interfund transactions.
<b>RECOMMENDATION</b>	We recommend that the <b>Municipality</b> prepare their financial statements using the information from their manual accounting records and Budget Liquidation, and to support the information presented as assets, liabilities, and net position/fund balance for all major and non-major funds.
<b>RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED</b>	The preparation of financial statements of FY 2012-2013 Budget Settlement and Report of Income and Disbursement worked with manual accounting records was used. We understand this audit was affected by adjustments for errors found in the corresponding initial balances the previous fiscal year. Once corrected and we proceeded to establish controls and procedures to maintain the correct balance.
<b>IMPLEMENTATION DATE</b>	May 2014
<b>RESPONSIBLE PERSON</b>	Jennifer Rosa, Finance Director

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	<b>2013-002</b>
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS IN PREPARED FINANCIAL STATEMENTS</b>
<b>CRITERIA</b>	Codification of Governmental Accounting and Financial Reporting Standards, Section 1400.101 states that the reporting entities should report general capital assets in governmental activities, proprietary and fiduciary funds. Capital assets includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period (AU § 1400.103). The <b>Municipality</b> should have established internal control policies and procedures in order to properly account for capital assets and to maintain adequate and updated inventory records that provide sufficient and competent evidence to support the existence, rights and obligations, completeness, and valuation and allocation, applicable to the capital assets in governmental activities of the Governmental-Wide Financial Statements.
<b>CONDITION</b>	During our audit the <b>Municipality</b> did not provide a subsidiary of capital assets that agreed with the amounts reported in governmental activities of the Governmental-Wide Financial Statements. Capital assets are the most significant assets of the <b>Municipality</b> and therefore, have a significant impact on the Governmental-Wide Financial Statements.
<b>CAUSE</b>	The <b>Municipality's</b> internal control system, failed to keep track of the additions of capital assets and to assure that the subsidiaries agree with the amounts presented in the Governmental-Wide Financial Statements.
<b>EFFECT OR POSSIBLE EFFECT</b>	The financial statements prepared by the <b>Municipality</b> presented the capital assets and depreciation expense in the Governmental-Wide Financial Statements that do not agree with the subsidiaries provided. In addition, the Governmental-Wide Financial Statements are misstated for an unknown amount related to construction in progress.
<b>RECOMMENDATION</b>	We recommend that the <b>Municipality</b> review the subsidiaries of capital assets in order to assure that they reconcile with the amounts presented in Governmental-Wide Financial Statements. In addition, review all those construction projects that comply with the capitalization policy of the <b>Municipality</b> , and are in progress, and adjust the subsidiaries and Governmental-Wide Financial Statements accordingly.
<b>RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED</b>	The <b>Municipality</b> is reviewing the Subsidiary of fixed assets, so that it includes all the necessary information and reliable financial statements.
<b>IMPLEMENTATION DATE</b>	May 2014
<b>RESPONSIBLE PERSON</b>	Jennifer Rosa, Finance Director

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	<b>2013-003 (See FINDING REFERENCE NUMBER 2013-006)</b>
<b>TYPE OF FINDING</b>	<b>MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS IN PREPARED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS</b>
<b>CRITERIA</b>	OMB Circular A-102 (Common Rule) Section __.20 Standards for financial management systems states: (a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to– (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes. The Objectives of internal control pertaining to the compliance requirements for Federal programs (Internal Control Over Federal Programs) as found in § __.105 of OMB Circular A-133, includes: Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and Federal reports.
<b>CONDITION</b>	During our audit procedures of the SEFA prepared by the <b>Municipality</b> we identified material misstatements related to the expenditures presented of all Federal programs. Adjustments were proposed in order to reconcile the information with the financial statements.

SECTION II – FINANCIAL STATEMENT FINDINGS

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<b>FINDING REFERENCE NUMBER</b>	<b>2013-004 (See FINDING REFERENCE NUMBER 2013-007)</b>
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE – REPORTING PACKAGE OF SINGLE AUDIT</b>
<b>CRITERIA</b>	OMB Circular A-133, Subpart C, Section .320 (a), (c), state all the audit shall be completed and the Data Collection Form and Reporting Package shall be submitted to the Federal Audit Clearinghouse designated by OMB within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.
<b>CONDITION</b>	The <b>Municipality</b> did not submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2013 during the required period.

SECTION II – FINANCIAL STATEMENT FINDINGS

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<b>FINDING REFERENCE NUMBER</b>	<b>2013-005 (See FINDING REFERENCE NUMBER 2013-008)</b>
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE</b>
<b>CRITERIA</b>	24 CFR Section 5.801 (c) (1) states that the financial information to be submitted to HUD in accordance with paragraph (b) of this section, must be submitted to HUD annually, no later than 60 days after the end of the fiscal year of the reporting period, and as otherwise provided by law. In addition, on Section (d) (1) states that audited financial statements will then be required no later than 9 months after the PHA's fiscal year end, in accordance with the Single Audit Act and OMB Circular A-133.
<b>CONDITION</b>	The <b>Municipality</b> did not submit the required Financial Reports to the US Housing and Urban Development of fiscal year ending June 30, 2013 during the required period. The unaudited version was submitted on September 3, 2013. The audited Financial Reports were not submitted on March 31, 2014.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2013-006 (See FINDING REFERENCE NUMBER 2013-003)
<b>FEDERAL PROGRAM</b>	ALL
<b>AWARD NUMBER</b>	(See Schedule of Expenditures of Federal Awards)
<b>COMPLIANCE REQUIREMENT</b>	REPORTING
<b>TYPE OF FINDING</b>	<b>MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS IN PREPARED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS</b>
<b>CRITERIA</b>	OMB Circular A-102 (Common Rule) Section __.20 Standards for financial management systems states: (a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to– (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes. The Objectives of internal control pertaining to the compliance requirements for Federal programs (Internal Control Over Federal Programs) as found in § __.105 of OMB Circular A-133, includes: Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and Federal reports.
<b>CONDITION</b>	During our audit procedures of the SEFA prepared by the <b>Municipality</b> we identified material misstatements related to the expenditures presented of all Federal programs. Adjustments were proposed in order to reconcile the information with the financial statements.
<b>CAUSE</b>	The SEFA prepared by the <b>Municipality</b> presented expenditures that didn't reconcile with the financial statements. The <b>Municipality</b> used the cash basis of accounting to present the expenditures in the SEFA, but their notes indicated that the modified basis of accounting was used to prepare the SEFA.
<b>EFFECT OR POSSIBLE EFFECT</b>	The <b>Municipality</b> was unable to comply with the submission of some reports due to the fact that the accounting records were not used to reconcile the SEFA with the financial statements.
<b>RECOMMENDATION</b>	We recommend that the <b>Municipality</b> maintain records in order to assure that all expenditures incurred from federal awards are properly incorporated in the SEFA. If the basis of accounting used to prepare the SEFA will be different with the one used to prepare the financial statements, the <b>Municipality</b> should reconcile the differences.
<b>RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED</b>	The <b>Municipality</b> will review all disbursements of federal funds so that you can present the SEFA reconciled and reliable.
<b>IMPLEMENTATION DATE</b>	May 2014
<b>RESPONSIBLE PERSON</b>	Jennifer Rosa, Finance Director Mable Cosme, Federal Programs Director María L. Delgado, Head Start Director

SECTION III – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2013-007 (See FINDING REFERENCE NUMBER 2013-004)
<b>FEDERAL PROGRAM</b>	CHILD AND ADULT CARE FOOD PROGRAM (10.558) U.S. DEPARTMENT OF AGRICULTURE PASS-THROUGH PUERTO RICO DEPARTMENT OF EDUCATION
<b>AWARD NUMBERS</b>	0000243865
<b>FEDERAL PROGRAM</b>	COMMUNITY DEVELOPMENT BLOCK GRANTS/ENTITLEMENT GRANTS (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
<b>AWARD NUMBER</b>	B-12-MC-72-0012
<b>FEDERAL PROGRAM</b>	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
<b>AWARD NUMBER</b>	RQ036
<b>FEDERAL PROGRAM</b>	HEAD START PROGRAM (93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES PASS-THROUGH PUERTO RICO DEPARTMENT OF FAMILY – ADMINISTRATION FOR THE CHILDHOOD CARE AND INTEGRAL DEVELOPMENT
<b>AWARD NUMBERS</b>	241-2012-000176-A; 241-2012-000202
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE – REPORTING PACKAGE OF SINGLE AUDIT</b>
<b>CRITERIA</b>	OMB Circular A-133, Subpart C, Section .320 (a), (c), state all the audit shall be completed and the Data Collection Form and Reporting Package shall be submitted to the Federal Audit Clearinghouse designated by OMB within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.
<b>CONDITION</b>	The <b>Municipality</b> did not submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2013 during the required period.
<b>CAUSE</b>	The <b>Municipality</b> were unable to provide timely the financial statements and related supporting documentation in order to apply required audit procedures.
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	The <b>Municipality</b> accounting records did not reconciled with the audited financial statements of prior year. Furthermore, during fiscal year 2012-2013, the <b>Municipality</b> did not have adequate accounting records in order to produce the financial statements with supporting documentation timely.
<b>EFFECT OR POSSIBLE EFFECT</b>	The <b>Municipality</b> did not comply with the submission date required for the Data Collection Form and Reporting Package.
<b>QUESTIONED COSTS</b>	None Noted.
<b>RECOMMENDATION</b>	We recommend management to implement adequate internal control procedures in order to assure that accounting records and supporting documentation is available on a timely manner.

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SECTION III – FINANCIAL STATEMENT FINDINGS

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<b>FINDING REFERENCE NUMBER</b>	2013-007 (See FINDING REFERENCE NUMBER 2013-004) – continuation
<b>RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED</b>	The <b>Municipality</b> will work on a Procedure to implement the necessary Internal Control in order to produce the financial statements with supporting documentation timely.
<b>IMPLEMENTATION DATE</b>	June 30, 2014
<b>RESPONSIBLE PERSON</b>	Jennifer Rosa, Finance Director

SECTION III – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2013-008 (See FINDING REFERENCE NUMBER 2013-005)
<b>FEDERAL PROGRAM</b>	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
<b>AWARD NUMBERS</b>	RQ036
<b>COMPLIANCE REQUIREMENT</b>	REPORTING
<b>TYPE OF FINDING</b>	MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE
<b>CRITERIA</b>	24 CFR Section 5.801 (c) (1) states that the financial information to be submitted to HUD in accordance with paragraph (b) of this section, must be submitted to HUD annually, no later than 60 days after the end of the fiscal year of the reporting period, and as otherwise provided by law. In addition, on Section (d) (1) states that audited financial statements will then be required no later than 9 months after the PHA's fiscal year end, in accordance with the Single Audit Act and OMB Circular A-133.
<b>CONDITION</b>	The <b>Municipality</b> did not submit the required Financial Reports to the US Housing and Urban Development of fiscal year ending June 30, 2013 during the required period. The unaudited version was submitted on September 3, 2013. The audited Financial Reports were not submitted on March 31, 2014.
<b>CAUSE</b>	The <b>Municipality</b> accounting records were not available timely in order to comply with the required submission dates.
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	The <b>Municipality</b> accounting records did not reconciled with the audited financial statements of prior year. Furthermore, during fiscal year 2012-2013, the <b>Municipality</b> did not have adequate accounting records in order to produce the financial statements with supporting documentation timely.
<b>EFFECT OR POSSIBLE EFFECT</b>	The <b>Municipality</b> did not comply with the submission date required for the Financial Reports to the US Housing and Urban Development.
<b>QUESTIONED COSTS</b>	None noted.
<b>RECOMMENDATION</b>	We recommend management to implement adequate internal control procedures in order to assure that accounting records and supporting documentation is available on a timely manner.
<b>RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED</b>	The REAC unaudited submission was submitted on September 3, 2013 with a comment in the area of Late Reason. The justification was accepted. However, the <b>Municipality</b> will assign a user id to an additional person to get access in REAC System in order to comply with the submission dates. The Audited Financial Report were not submitted on March 31, 2014. However, the <b>Municipality</b> will work on a Procedures to implement the necessary Internal Control in order to produce the financial statements with supporting documentation timely. In order to comply with the submission dates.
<b>IMPLEMENTATION DATE</b>	Next Reporting Period
<b>RESPONSIBLE PERSON</b>	Jennifer Rosa, Finance Director

END OF SCHEDULE

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**(1) Audit Findings that have been Fully Corrected:**

**NONE**

**(2) Audit Findings not Corrected or Partially Corrected:**

**NONE**

**(3) Corrective action taken is significantly different from corrective action previously reported:**

**NONE**

**(4) Audit findings is no longer valid:**

**NONE**

**END OF SCHEDULE**