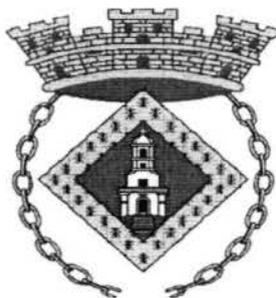




**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

*BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND INDEPENDENT
AUDITORS' REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)*

*AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2013*



*Hon. Pedro J. García-Figueroa
Mayor*

*Mrs. Miriam Irizarry
Finance Director*

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES (DEFICIT) -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2013

	Major Funds						Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Bonds and Note Issuance Fund	Other Governmental Funds	
Revenues:							
Taxes:							
Property taxes	\$ 1,971,872	\$ -	\$ -	\$ 817,607	\$ -	\$ -	\$ 2,789,479
Municipal license taxes	1,463,200	-	-	-	-	-	1,463,200
Sales and use taxes	1,603,196	-	-	520,422	-	-	2,123,618
Intergovernmental:							
Commonwealth Government	3,881,869	-	100,553	-	-	279,490	4,261,912
Federal Government	-	812,104	-	-	-	1,332,221	2,144,325
Fees, fines and charges for services	2,832,502	2,111	-	6,346	-	33,606	2,874,565
Interest	5,398	-	-	2,463	50,352	-	58,213
Other	181,968	-	-	-	-	-	181,968
Total Revenues	11,940,005	814,215	100,553	1,346,838	50,352	1,645,317	15,897,280
Expenditures							
General government	6,050,738	96,504	-	227,972	-	238,440	6,613,654
Public works and sanitation	2,784,065	19,170	23,182	-	34,565	174,668	3,035,650
Public safety	862,897	-	-	-	-	93	862,990
Culture and recreation	834,673	-	-	-	-	-	834,673
Health	361,263	-	-	-	-	-	361,263
Housing, welfare and community development	630,117	120,766	49,535	-	-	1,236,482	2,036,900
Education	21,900	-	-	-	-	-	21,900
Capital outlays	358,056	755,952	134,488	-	631,980	68,512	1,948,988
Debt service:							
Principal	-	-	-	942,000	-	-	942,000
Interest	-	-	-	620,301	-	-	620,301
Bond issuance costs	-	-	-	-	9,282	-	9,282
Total expenditures	11,903,709	992,392	207,205	1,790,273	675,827	1,718,195	17,287,601
Excess (deficiency) of revenues over expenditures	36,296	(178,177)	(106,652)	(443,435)	(625,475)	(72,878)	(1,390,321)
Other financing sources (uses):							
Lease principal payments	76,152	-	-	-	-	-	76,152
Payment of long-term debt to PREPA	(531,907)	-	-	-	-	-	(531,907)
Proceeds from general obligation bonds	-	-	-	-	2,010,000	-	2,010,000
Transfers in	1,087,869	-	-	257,691	-	180,121	1,525,681
Transfers out	(437,812)	-	-	(1,037,517)	(50,352)	-	(1,525,681)
Total other financing sources (uses)	194,302	-	-	(779,826)	1,959,648	180,121	1,554,245
Net change in fund balances (deficit)	230,598	(178,177)	(106,652)	(1,223,261)	1,334,173	107,243	163,924
Fund balances (deficit) at beginning of year, as restated	1,028,735	(468,218)	187,688	2,196,270	636,209	(66,533)	3,514,151
Fund balances (deficit) at end of year	\$ 1,259,333	\$ (646,395)	\$ 81,036	\$ 973,009	\$ 1,970,382	\$ 40,710	\$ 3,678,075

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2013

Net change in fund balances (deficit) - total governmental funds:	\$	163,924
Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental funds reports capital assets 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:		
Expenditures for capital assets	\$ 1,952,960	
Less: current year depreciation	<u>(2,024,321)</u>	(71,361)
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net position differs from the change in fund balance by the cost of the disposed asset:		
		(131,978)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Receivables:		
Municipal licenses	1,656	
Sales tax	115,036	
Municipal properties rent	69,925	
Municipal other income	1,960	
Municipal permits	14,681	
Intergovernmental - Commonwealth Government:		
P.R. Department of Treasury - Christmas bonus reimbursement (current)	88,622	
P.R. Department of Education	9,190	
CRIM - Property tax final settlement	48,463	
Commonwealth Legislature Resolutions	2,754	
P.R. Electric Power Authority (PREPA)	390,424	
P.R. Department of Family	29,592	
Intergovernmental - Federal Government:		
OCAM - CDBG	491,717	
Federal Transit Administration	12,990	
Emergency Shelter Grant	<u>435</u>	1,277,445
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
CRIM - Property tax preliminary settlement	(184,283)	
Sales and use tax	(604)	
P.R. Department of Treasury - Christmas bonus reimbursement (prior year)	(165,221)	
P.R. Department of Education	(10,673)	
P.R. Office of the Ombudsman for the Elderly - Titles III-D and E	(33,033)	
P.R. Department of Health - HOPWA	(2,782)	
P.R. Electric Power Authority (PREPA)	(336,694)	
P.R. Solid Waste Administration	(28,080)	
P.R. Infrastructure Financing Authority - PINI Funds	(1,386)	
OCAM - CDBG	(303,565)	
Emergency Shelter Grant	(7,317)	
P.R. Department of Housing - PRPHA	(2,537)	
Capital lease principal payment	<u>(67,484)</u>	(1,143,659)
Proceeds from general obligation bonds are other financing sources in the governmental funds, but increase in long-term liabilities in the Statement of Net Position:		
		(2,010,000)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		(51,000)
Repayment of long-term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Position:		
General Obligation Bonds and Notes	993,000	
Other Long-Term Liabilities	<u>1,012,005</u>	2,005,005
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 the governmental funds:		
Christmas Bonus	(177,245)	
P.R. Electric Power Authority (PREPA)	(585,636)	
Bond issuance costs	(87,376)	
Estimated landfill closing costs	(37,302)	
Compensated Absences	(317,864)	
Transfer of capital asset to PRASA	(5,042,532)	
Accrued interest (net change)	<u>5,595</u>	(6,242,360)
Change in net position of governmental activities:	\$	(6,203,984)

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE R – CONTINGENCIES

1. Federal and Commonwealth Grants

Projects financed by the Federal and Commonwealth Grants are subject to audits by grantors and other governmental agencies in order to determine that the expenditures complies with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to be performed.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that would not be covered by insurance. However, it is the opinion of the Municipality and legal counsel that, based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

NOTE S – RESTATEMENT OF FUND BALANCE AND NET POSITION

The following table disclosed the net change in fund balances and net position at beginning of year as previously reported in the financial statements. The beginning balances have been restated as follows:

<u>Description</u>	<u>Fund Balance</u>	<u>Net Position</u>
	<u>General Fund</u>	<u>Government-Wide Statements</u>
Fund balance / net position, at beginning of year, as previously reported	\$ 1,288,509	\$ 35,152,963
Correction of error, recording of cash book balance in the general fund	(259,774)	(259,774)
Fund balance / net position, at beginning of year, as restated	\$ 1,028,735	\$ 34,893,189

NOTE T – SUBSEQUENT EVENTS

The Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit rating agencies have been consistently downgrading the Commonwealth's and certain public corporation's general obligation bond ratings. In order to address these matters the Commonwealth began to enact legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico ("GDB"), its fiscal agent, and strengthen sinking funds to assess financial markets. The Commonwealth estimates that the following corrective actions, among others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE T – SUBSEQUENT EVENTS – Continued

1. Pension System Reform

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

- a. Moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new hybrid plan (“New Plan”).
- b. 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 New Plan. Participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.
- c. Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual’s life expectancy and a rate of return.
- d. New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees’ contributions plus a return on investment)
- e. Eliminates the possibility of accruing a merit pension (payable once the participant has achieved 30 years of creditable service) after June 30, 2013.
- f. Increases employee contributions from 8.275% to a minimum of 10%.
- g. After July 1, 2013 all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016 an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. These contributions will be used to increase the System’s assets, reduce the actuarial deficit and enable the System to comply with future obligations.
- h. Retirement age will be modified as follows:
 - 1) Act 447 regular employees: age 58 to 61,
 - 2) Act 447 high risk employees (state and municipal police, firefighters and custody officials): from age 50 to 55 years,
 - 3) Act 305 (System 2000) regular employees: age 60 to 65; high risk employees remains the same (55 years).

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET POSITION
JUNE 30, 2013**

Total governmental fund balances: **\$ 3,678,075**

Amounts reported for governmental activities in the Statement of Net Position are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds: 41,341,080

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

Receivables:

Lease agreement	60,279	
Municipal licenses and sales tax	247,904	
Municipal properties rent	69,925	
Municipal other income	1,960	
Municipal permits	14,681	

Due from Commonwealth Government:

P.R. Department of Treasury - Christmas bonus reimbursement	88,622	
Commonwealth Legislature Resolutions	2,771	
P.R. Department of Education	9,190	
CRIM - Property tax final settlement	48,463	
P.R. Electric Power Authority (PREPA)	617,451	
P.R. Department of Family	29,592	

Due from Federal Government:

Federal Transit Administration	12,990	
Emergency Shelter Grant	435	
OCAM - CDBG and CDBG - ARRA	649,429	1,853,692

Interest liabilities are not due and payable in the current period and, therefore, are not reported in funds (81,816)

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

General obligation bonds and notes	(14,500,000)	
Note payable to CRIM-financing of delinquent accounts	(3,788)	
Compensated absences	(1,479,132)	
Christmas bonus payable	(177,245)	
Prior year property tax	-	
Estimated landfill closing costs	(1,324,211)	
P.R. Electric Power Authority (PREPA)	(617,450)	(18,101,826)

Net position of governmental activities: **\$ 28,689,205**

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE O – RETIREMENT PLAN – Continued

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets which will be invested by the System together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If the savings account balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions have not been granted under the new program. The employer contributions (11.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600, except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary.

As of June 30, 2012, the ERS has an unfunded actuarial accrued liability of approximately \$26.4 billion. In the opinion of management if measures are not implemented to deal with this situation, the ERS's net assets will be exhausted by fiscal year 2015. In order to address this issue, among other measures, on July 6, 2011 (effective July 1, 2011) the Commonwealth Legislature approved Act No. 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for fiscal year 2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The purpose of this Act is to provide cash flow and strengthen the System to adequately cover administrative expenses and payment of benefits.

The Municipality is required to contribute 11.275% of gross salary for fiscal year 2013. As stated in the Act, percent increases applicable to municipalities for fiscal years 2011-2012, 2012-2013 and 2013-2014 would be financed through the Commonwealth's budget approved by the Commonwealth's Legislature. The Municipality's actual contribution for Law 447 and System 2000 are \$326,019, \$347,530, and \$359,848 for the years ended on June 30, 2013, 2012, and 2011, respectively.

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3, representing a comprehensive reform of the ERS. See related Note T.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE P – POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note O, as of June 30, 2013 the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth laws. Also, the Municipality is required to finance costs related to the application of certain “Special Laws” issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicine bonus, Christmas bonus and death benefits. For fiscal year 2013, costs related to these post-employment benefits amounted to \$99,891. These benefits are recorded as expenditures in the general fund.

NOTE Q – COMMITMENTS

1. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less, and are automatically renewed for the same terms. Rental expenses amounted to \$154,869. Management believes that the summary of the future minimum rental commitments under non-cancelable operating leases with terms exceeding one year is not significant.

2. Construction

As of June 30, 2013 the Municipality has commitments of \$445,182 for design, construction, improvements or renovation of certain municipal facilities.

3. Encumbrances

The Municipality has encumbrances outstanding which represent the estimated amount of expenditures required to complete contracts, purchase orders and other commitments in process of completion at fiscal year-end. Outstanding encumbrances as of June 30, 2013 in the general fund represent unassigned amounts that are encumbered and are classified by management as assigned fund balance. Purpose classification follows:

Purpose	General Fund- assigned fund balance
General public works and sanitation	\$ 28,448
Public safety	199
Sports, Culture and recreation	4,403
Housing, welfare and community development	4,100
Health	42
General government and other purposes	13,533
	\$ 50,725

The fund balance of major and other governmental funds (special revenue, capital project and debt service fund) is classified as restricted, some or all of which may be encumbered. Encumbrances of restricted fund balances are not reported separately from this classification because the encumbrance does not further restrict the purpose for which the resources may be used.

FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

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INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Hormigueros (the Municipality), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' 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 from 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 through 14 and 56 through 58 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other 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 Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements. The Financial Data Schedule supplementary information on pages 59 through 61 is required by the Uniform Reporting Standards of the Department of Housing and Urban Development, and is also not a required part of the basic financial statements.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2014, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Municipality's internal control over financial reporting and compliance.

Valdés, Saraín, María E Martínez, LLP

San Juan, Puerto Rico
March 28, 2014

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MANAGEMENT'S DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

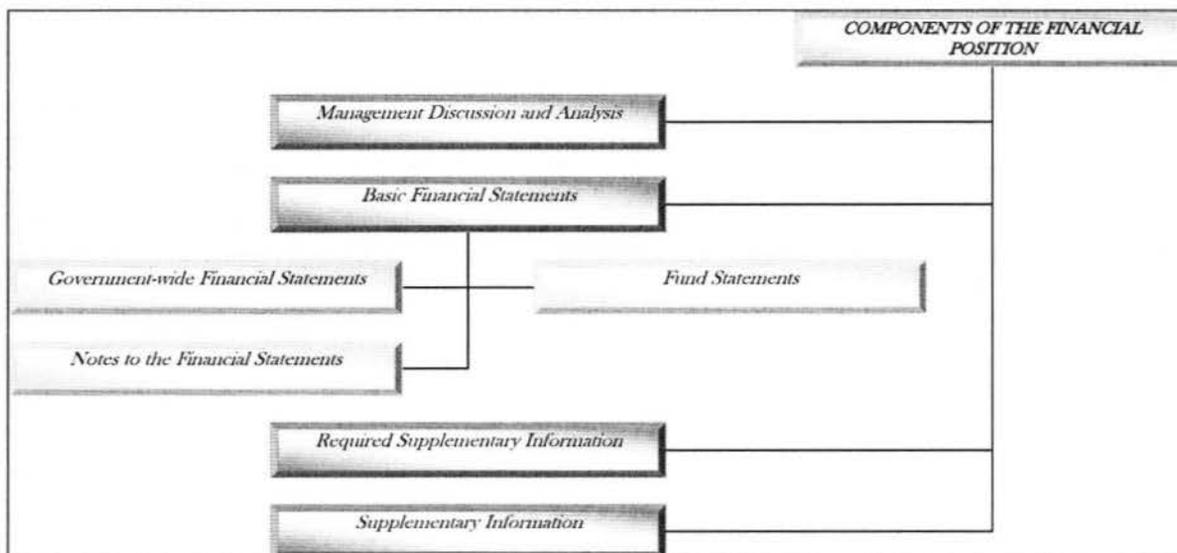
The discussion and analysis of the Municipality of Hormigueros' financial performance provides an overall review of the Municipality's financial activities for the year ended June 30, 2013. The intent of this discussion and analysis is to look at the Municipality's financial performance as a whole; this section should be read in conjunction with the basic financial statements to obtain a better understanding of the financial position and the results of operations of the Municipality. Our analysis follows this section.

FINANCIAL HIGHLIGHTS

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2013 by \$28,689,205 (net position), a decrease of 18% in comparison with 2012. Of this amount, the Municipality presented an unrestricted net position (deficit) of \$(2,579,767).
- Revenues decreased 4% and expenses increased 33% when compared with fiscal year 2012. Net position decreased \$6,203,984 in 2013.
- A positive net change in the fund balances of the Municipality's governmental funds of \$163,924 in the fiscal year 2013 resulted in reported ending fund balances of \$3,678,075 increasing 5% with respect to the 2012 year. Approximately 14% of the total fund balances is unrestricted (assigned or unassigned).
- For fiscal year 2013, the General Fund reported an excess of revenues and other financing sources over expenditures and other financing uses of \$230,598. The unassigned fund balance amounts to \$483,168 for an increase of 123% as compared to 2012.
- The investment in capital assets as of June 30, 2013 was \$41,341,080 (net of depreciation).
- Long-term debt (total primary government) increased to \$18,809,826 or approximately 6% with respect to the prior year.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$387,405. After adding additional resources from a readjustment of prior year fund balance, the total excess amounts to \$512,405.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's financial report comprises four components: (1) management's discussion and analysis (presented here), (2) basic financial statements, (3) required supplementary information and (4) other supplementary information.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

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 all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference 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 capital assets 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.

The government-wide statements report as governmental activities the Municipality's basic services such as public works and sanitation, public safety, culture and recreation, housing, welfare, 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 as 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 as on balances of spendable 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

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 comply with a minimum criterion, that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official criteria if the fund is particularly important to financial statement users. Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

- *Notes to financial statements*

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information

The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund.

Supplementary information

The supplementary information also includes a financial data schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

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:

TABLE 1
*Summary Statement of Net Position
As of June 30,*

	Governmental Activities	
	2013	2012 (As restated)
Assets		
Current and other assets	\$ 9,464,074	\$ 9,225,683
Capital assets	41,341,080	46,586,952
Total assets	<u>\$ 50,805,154</u>	<u>\$ 55,812,635</u>
Liabilities		
Current and other liabilities	3,306,123	3,232,662
Long-term liabilities	18,809,826	17,686,784
Total liabilities	<u>22,115,949</u>	<u>20,919,446</u>
Net Position		
Net investment in capital assets	29,668,569	34,686,700
Restricted	1,600,403	3,008,075
Unrestricted (deficit)	(2,579,767)	(2,801,586)
Total net position	<u>\$ 28,689,205</u>	<u>\$ 34,893,189</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

Net position (difference of non-fiduciary assets, deferred outflows versus liabilities and deferred inflows) serve as a useful indicator of a government's financial position. Over time, increases or decreases in the Municipality's net position is one indicator of whether its financial health is improving or deteriorating. At June 30, 2013, assets exceeded its liabilities by \$28,689,205. Of this amount, \$(2,579,767) represents unrestricted net position (deficit). This deficit primarily arises from long-term obligations such as compensated absences, landfill closure and post-closure costs, among other debts, 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. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as net investment in capital assets. Therefore, they are reported as part of the unrestricted net position section. Restricted net position represents resources that are subject to external restrictions on how they may be used.

The largest portion of the Municipality's net position reflects its investment in capital assets (land, buildings, equipment, and infrastructure) less accumulated depreciation and less any related outstanding debt used to acquire 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 purpose of retiring debt.

Net position reported a decrease of 18% with respect to the fiscal period 2012. The most significant transaction that causes this negative variance is the donation of an infrastructure capital asset to the Puerto Rico Aqueduct and Sewer Authority ("PRASA"). As more detailed in Note G, the Municipality entered into agreements with agencies and instrumentalities of the Commonwealth to perform the construction of certain infrastructure projects which are included as part of the Municipality's capital assets until construction is completed in which they are recorded as an expense in the Statement of Activities and transferred to the applicable agency. During the fiscal year 2012-2013 the Municipality transferred to PRASA the "Lavadero Sanitary Sewer System", which total cost amounting to \$5,042,532 was recorded as public works and sanitation expense in the Statement of Activities. This transaction caused an increase of 33% in expenses as compared with the 2012 year and causes the general decrease in net position versus the 2012 fiscal year.

Changes in net position

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

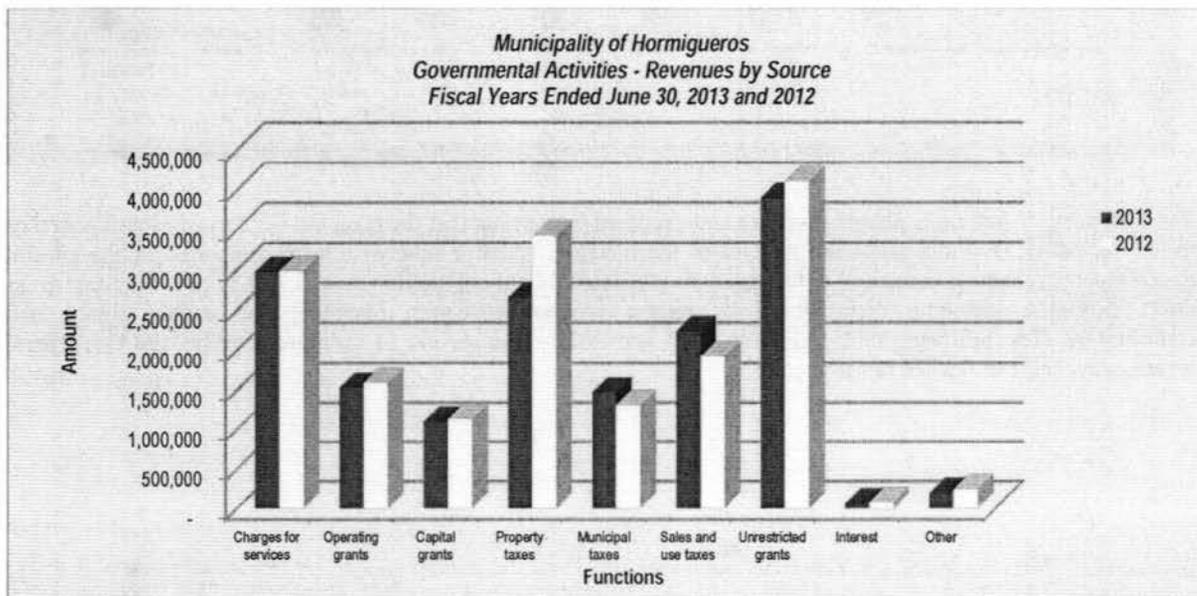
TABLE 2
Summary of Changes in Net Position
As of June 30,

	Governmental Activities	
	2013	2012
Program revenues:		
Fees, fines and charges for services	\$ 2,978,541	\$ 2,985,711
Operating grants and contributions	1,526,115	1,587,095
Capital grants and contributions	1,099,556	1,129,697
General revenues:		
Property taxes	2,653,659	3,423,749
Municipal license taxes	1,464,856	1,307,454
Sales and use taxes	2,238,051	1,923,655
Grants and contributions not restricted to specific programs	3,895,630	4,104,159
Interest	58,213	70,383

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

<i>Summary of Changes in Net Position As of June 30,</i>		
	Governmental Activities	
	2013	2012
Other	192,596	232,702
Total revenues	\$16,107,217	\$16,764,605
Expenses:		
General government	7,653,780	7,765,612
Public works and sanitation	8,888,438	3,383,331
Public safety	1,007,038	915,056
Culture and recreation	1,482,449	1,338,326
Health	371,227	375,991
Housing, welfare and community development	2,180,398	2,360,190
Education	113,066	43,925
Interest on long term debt	614,805	631,959
Total expenses	22,311,201	16,814,390
Change in net position	(6,203,984)	(49,785)
Net position-beginning of year, as restated	34,893,189	34,942,974
Net position-end of year	\$ 28,689,205	\$ 34,893,189

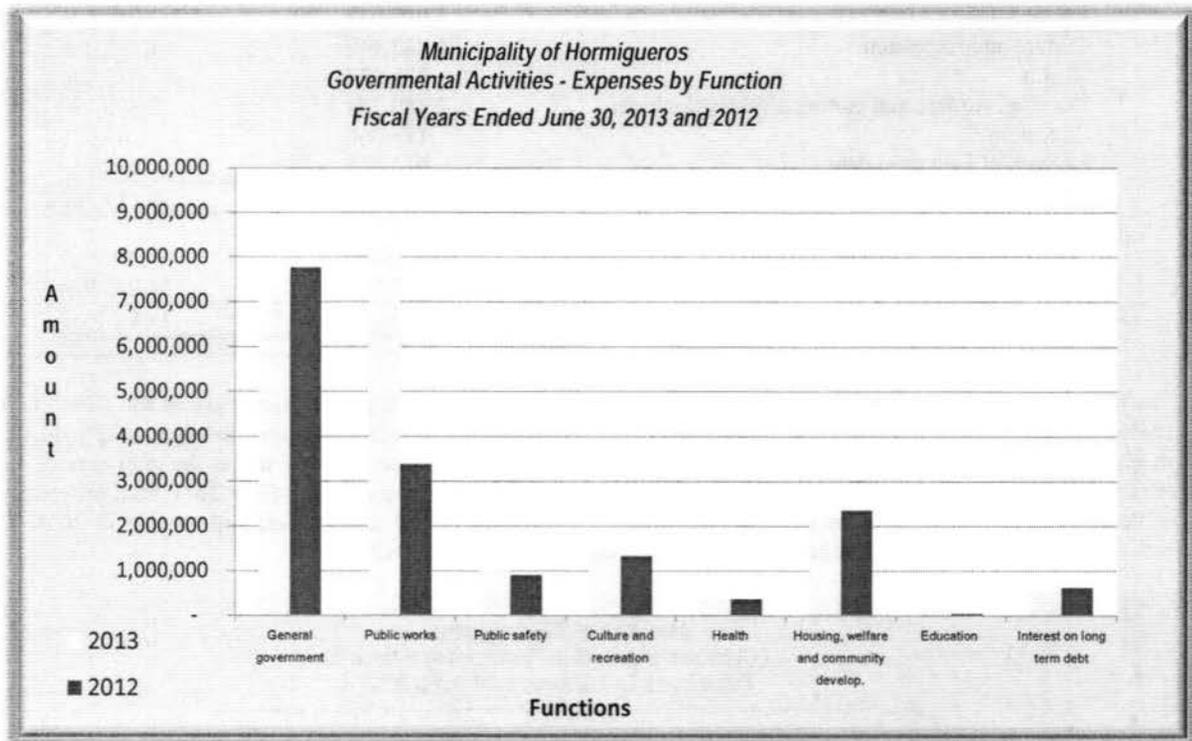
The three major sources of revenues of the Municipality in fiscal year 2013 are: unrestricted grants and contributions (24%), charges for services (18%) and property taxes (16%). Revenues decreased 4% due mainly to a 22% decrease in property tax revenue. During 2012 year the Municipality received more property tax at the debt service fund (CAE) for additional tax revenues on August 2011 and also received the proceeds of the 2011 final property tax settlement. Those resources were in excess of revenues recognized for the same period and concept in 2013. The following **Figure 1** illustrates the revenue comparison between 2013 and 2012:



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

The Municipality's expenses cover a range of services. The largest expenses are public works and sanitation with 40% and general government with 34%.

Total expenses increased 33% when compared with fiscal year 2012. The main reason of this is an increase of 163% in public works and sanitation function due to the transfer to PRASA of the "Lavadero Sanitary Sewer System", which total cost amounting to \$5,042,532 was recorded as public works and sanitation expense in the Statement of Activities. As a result, the net position decreased \$6,463,758 or 18% with respect to the prior year restated net position. The following **Figure 2** illustrates the expenses comparison between 2013 and 2012:



The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. The following table discloses 2013 and 2012 expenses net of program revenue and the general revenues available to finance remaining costs:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

TABLE 3

<i>Expenses Net of Program Revenues As of June 30, 2013</i>		
Net expenses	2013	2012
General government	\$ (4,555,329)	\$ (4,568,017)
Public works and sanitation	(7,607,639)	(2,152,494)
Public safety	(998,522)	(895,749)
Culture and recreation	(1,465,609)	(1,318,741)
Health	(371,227)	(375,991)
Housing, welfare and community development	(980,792)	(1,125,010)
Education	(113,066)	(43,925)
Interest on long-term debt	(614,805)	(631,959)
Total expenses, net of program revenues	(16,706,989)	(11,111,886)
General revenues		
Taxes	6,356,566	6,654,858
Grants and contributions not restricted to specific programs	3,895,630	4,104,159
Interest and other	250,809	303,086
Total general revenues	10,503,005	11,062,103
Change in net position	\$ (6,203,984)	\$ (49,785)

Like in the previous year, the net cost of services \$(16,706,989) was not covered by other general revenues. As described in the financial analysis of net position during the fiscal year 2012-2013 the Municipality transferred to PRASA the "Lavadero Sanitary Sewer System", which total cost amounting to \$5,042,532 was recorded as public works and sanitation expense in the Statement of Activities. This transaction caused the general decrease in net position in 2013 versus 2012 fiscal year.

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, unassigned fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by either an external party.

For the fiscal year ended June 30, 2013, the governmental funds reported ending fund balances of \$3,678,075, a net increase of 5% in comparison with the prior year. Of the total fund balances, \$518,324 (or 14%) constitutes unrestricted fund balance, of which \$(257,841) (or 7%) are unassigned funds with a net deficit. The remainder of the fund balances is restricted to indicate that it is not available for new spending. Following is a summary of the financial analysis of the Municipality's major funds:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

- ***General Fund***

The general fund is the operating fund of the Municipality. The fund balance of the general fund represents approximately 34% of total ending fund balances. Of the total fund balance 62% is assigned mainly for capital outlays, public works, and general government purposes. The remainder of the unrestricted fund balance of \$483,168 is unassigned fund balance, which represents 38% of the total fund balance of the general fund. Unassigned fund balance increased 123% with respect to the prior year.

During the fiscal year the fund balances of the general fund increased by \$230,598. The main sources of revenues of the general fund in fiscal year 2013 are: taxes (property taxes, sales and use taxes and municipal license taxes) with 42%, intergovernmental subsidies from the Commonwealth with 33%, and charges for services with 24%. Revenues increased 4% in comparison to 2012 due to increases in taxes, intergovernmental revenues and charges for services. The largest expenditures of the general fund are general government with 51% and public works and sanitation with 23%. Expenditures also increased 4%.

- ***Community Development Block Grant Program Fund("CDBG")***

The CDBG Fund is composed of the Community Development Grant Program/State's Program, received through the Office of Commissioner of Municipal Affairs, a Commonwealth's governmental agency. With respect to the previous year, the CDBG fund operation presents a decrease of 4% in expenditures since funds related to ARRA-CDBG were finally expended in 2012. Since revenues are recorded as expenditures are incurred, the fund presents a decrease in revenues. Fund balance presents a deficit as liabilities and deferred inflows of resources exceed assets for unavailable revenues recorded.

- ***Commonwealth Legislature Fund***

This fund report revenue sources from grants provided by the Commonwealth's Legislature restricted for specific purposes. During the 2013 the fund balance decreased \$106,652. The fund received additional grants of \$100,553. Amounts were expended in public works, welfare projects and capital outlays.

- ***Debt Service Fund***

The debt service fund had a decrease in fund balance during the current year of \$(1,223,261) to bring the year end fund balance to \$973,009 which represents 26% of total fund balances. The decrease results from transfers to the general fund of excess funds deposited in the Municipal Redemption Fund and the liquidation of an "IBA" sinking fund created to repay a revenue bond which was fully repaid in 2012. Revenues decreased 32% since during the 2012 year the Municipality received more property tax at the debt service fund (CAE) for additional tax revenues on August 2011 and also received the proceeds of the 2011 final property tax settlement.

- ***Bonds and Notes Issuance Fund***

The Municipality reports in this fund the bonds and notes issued through the Governmental Development Bank of Puerto Rico ("GDB"). During 2013 there was an issuance of a special obligation bond of \$2,010,000. The fund expended \$631,980 in capital projects during 2013.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal year 2012-2013 presented a 1% increase with respect to the prior year budget. It was amended by transfers from other special accounts for a total amount of \$84,590. Actual revenues exceeded revised budgeted revenues by \$379,153 (net). The Municipality also reported a positive variance of \$129,776 between revised budgeted appropriations and actual expenditures. Actual revenues exceeded actual expenditures by \$387,405 but after including additional resources from prior year fund balance surpluses the total excess of funds amounts to \$512,405.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$41,341,080 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net decrease of 11% over the prior year. The following **Table 4** discloses the capital assets balances as of June 30, 2013:

TABLE 4

<i>Capital Assets, net As of June 30,</i>		
	Governmental Activities	
	2013	2012
Non-depreciable assets:		
Land	\$ 8,263,861	\$ 8,232,361
Construction in progress	1,642,493	8,050,541
Depreciable assets (net):		
Land improvements	1,101,052	1,183,143
Buildings and buildings improvements	23,092,368	21,318,458
Infrastructure	5,339,628	5,423,738
Vehicles, machinery and equipment	1,901,678	2,378,711
Total	\$ 41,341,080	\$ 46,586,952

The Municipality's major capital projects that were still in construction and the related construction in progress cost as of June 30, 2013 are as follows:

- "Centro Comunal Hoya Grande" - \$778,826
- "Mejoras Complejo Deportivo Federico Mendez (Hoya Grande)" – \$222,550
- "Proyecto Viviendas Lavadero de Oro" - \$176,245

With respect to 2012 there was a significant decrease in construction in progress. During the fiscal year 2012-2013 the Municipality completed the construction and transferred to PRASA the "Lavadero Sanitary Sewer System", which total cost amounting to \$5,042,532 was recorded as public works and sanitation expense in the Statement of Activities. In addition, a major project "Pista Atlética 400 Metros" for a total cost of \$2,182,282 was finished and transferred to the building and building improvements function. Equipment for a total amount of \$81,209 was placed in use during 2013 including two cars for a total cost of \$16,946 each, and a minivan for a total cost of \$24,138.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

The Municipality's fiscal year 2013-2014 capital budget calls for a significant amount of projects including the second phase of "Plaza Vista a la Bahía" with an estimated total cost of \$98,475 and, improvements to Infrastructure in the San Romualdo Sector with an estimated total cost of \$51,384.

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

Long-term debt

The following is a summary of the Municipality's outstanding debt as of June 30, 2013 and 2012:

TABLE 5

<i>Outstanding Long-term Debt Fiscal years ended June 30,</i>		
	Governmental Activities	
	2013	2012
General and special obligation bonds and notes	\$ 15,208,000	14,191,000
Note payable to CRIM – financing of delinquent accounts	3,788	3,987
Payable to PREPA	617,450	563,720
Compensated absences	1,479,132	1,343,806
Christmas bonus payable	177,245	207,504
Estimated landfill closing costs	1,324,211	1,286,909
Payable to CRIM – property tax advances	-	89,858
Total	\$ 18,809,826	\$ 17,686,784

At year-end, the Municipality had outstanding \$15,208,000 in general and special bonds and notes, an increase with respect to the prior year because of the issuance of the \$2,010,000 special obligation bond during 2013. The Municipality has no significant change in other long-term debts (other than general obligation bonds and notes) with respect to 2012 year.

More detailed information about the Municipality's long-term liabilities is presented in Note H of the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's officials considered certain factors when establishing the fiscal year's 2013-2014 budget. One of these factors is the economy. Among economic areas considered are the estimates for the growth or decline in population, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate at June 2013 stands at 15%, and the Commonwealth rate stands at 13.8%.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

For year 2013-2014 the Municipality applied a conservative approach in the development of budget estimates. The amount available for appropriations in the General Fund is \$10,716,764 which is essentially the same amount with respect to prior year estimates. Budgeted expenditures are expected to rise according to the increase of budgeted revenues. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase modestly by the close of the 2013-2014 fiscal year. In addition to the general fund estimated budget the Municipality plans to submit to the Federal and Commonwealth government fund proposals for welfare and community development as well as permanent capital improvements and public works.

As more fully described in Note T the Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit rating agencies have been consistently downgrading the Commonwealth's and certain public corporation's general obligation bonds ratings. In order to address these matters the Commonwealth began to make legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico ("GDB"), their fiscal agent, and strengthen sinking funds to assess financial markets. The Commonwealth estimates that these corrective actions, among others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens. Among other actions, on January 24, 2014, the Commonwealth approved Acts No. 18 and 19. Those Acts provide for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long-term debt issuances. As a result of this legislation the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

On February 4, 2014, February 7, 2014 and February 11, 2014 Standard & Poor's Rating Services ("S&P"), Moody's Investors Service ("Moody's") and Fitch Ratings ("Fitch"), respectively, lowered their ratings on the Commonwealth of Puerto Rico's general obligation (GO) debt and other of its instrumentalities such as GDB, ERS and COFINA. The downgrades follow S&P's, Moody's and Fitch's evaluation of liquidity and access to markets. It is the opinion of the Municipality's management that the corrective actions taken and to be taken in current and fiscal periods thereafter will lower the impact of this decision and cause a positive turnaround on the Commonwealth's and the Municipality's finances.

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 any questions about this report or need any additional information contact the Finance Department at the Municipality of Hormigueros at P.O. Box 97, Hormigueros, Puerto Rico 00660.

BASIC FINANCIAL STATEMENTS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
STATEMENT OF NET POSITION
JUNE 30, 2013

ASSETS	<u>Governmental Activities</u>
Cash and cash equivalents	\$ 2,307,910
Receivables, net:	
Municipal license taxes	134,612
Sales and use taxes	222,191
Lease	60,279
Other	114,545
Due from:	
Commonwealth Government	943,259
Federal Government	813,039
Restricted assets:	
Cash and cash equivalents	363,334
Cash with fiscal agents	4,430,931
Investment held with fiscal agent	73,335
Other assets	639
Capital assets:	
Land and construction in progress	9,906,355
Other capital assets, net	31,434,725
Total capital assets, net	<u>41,341,080</u>
Total assets	<u>\$ 50,805,154</u>
LIABILITIES	
Accounts payable and accrued liabilities	\$ 1,811,389
Interest payable	318,413
Due to Commonwealth Government	14,159
Unearned Revenues:	
Municipal license taxes	1,158,384
Intergovernmental - Federal grants	3,778
Long term liabilities:	
Due within one year	1,753,643
Due in more than one year	17,056,183
Total liabilities	<u>22,115,949</u>
NET POSITION	
Net investment in capital assets	29,668,569
Restricted for:	
Debt service	1,599,193
Other purposes	1,210
Unrestricted (deficit)	<u>(2,579,767)</u>
Total net position	<u>\$ 28,689,205</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2013

Functions	Expenses	Program Revenues			Net (Expenses) Revenues and Change in Net Position
		Fees, Fines and Charges for services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General government	\$ 7,653,780	\$ 2,918,710	\$ 179,741	\$ -	\$ (4,555,329)
Public works and sanitation	8,888,438	37,753	143,490	1,099,556	(7,607,639)
Public safety	1,007,038	-	8,516	-	(998,522)
Culture and recreation	1,482,449	16,840	-	-	(1,465,609)
Health	371,227	-	-	-	(371,227)
Housing, welfare and community development	2,180,398	5,238	1,194,368	-	(980,792)
Education	113,066	-	-	-	(113,066)
Interest on long-term debt	614,805	-	-	-	(614,805)
Total	\$ 22,311,201	\$ 2,978,541	\$ 1,526,115	\$ 1,099,556	\$ (16,706,989)

General revenues:

Taxes:

Property taxes	2,653,659
Municipal license taxes	1,464,856
Sales and use taxes	2,238,051
Grants and contributions not restricted to specific programs	3,895,630
Interest	58,213
Other	192,596

Total general revenues 10,503,005

Change in net position (6,203,984)

Net position-beginning, as restated 34,893,189

Net position-ending \$ 28,689,205

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BALANCE SHEET -
GOVERNMENTAL FUNDS
JUNE 30, 2013

	Major Funds						Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Bonds and Note Issuance Fund	Other Governmental Funds	
Assets							
Cash and cash equivalents	\$ 2,307,910	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,307,910
Receivables, net							
Municipal license taxes	134,612	-	-	-	-	-	134,612
Sales and use taxes	222,191	-	-	-	-	-	222,191
Lease	60,279	-	-	-	-	-	60,279
Other	94,439	-	-	-	-	20,107	114,546
Due from:							
Commonwealth Government	800,807	-	30,676	75,627	-	36,149	943,259
Federal Government	-	775,495	-	-	-	37,544	813,039
Other funds	401,043	-	-	-	-	-	401,043
Restricted assets							
Cash and cash equivalents	-	7,288	261,383	-	-	94,663	363,334
Cash with fiscal agents	-	-	-	1,845,527	2,505,456	79,948	4,430,931
Investment held with fiscal agent	-	-	-	-	73,335	-	73,335
Other asset	-	-	-	-	597	42	639
Total assets	\$ 4,021,281	\$ 782,783	\$ 292,059	\$ 1,921,154	\$ 2,579,388	\$ 268,453	\$ 9,865,118
Liabilities, Deferred Inflows of Resources and Fund Balances (deficit)							
Liabilities:							
Accounts payable and accrued liabilities	\$ 434,023	\$ 542,420	\$ 208,252	\$ -	\$ 561,297	\$ 65,398	\$ 1,811,390
Matured bonds and interest payable	-	-	-	944,601	-	-	944,601
Due to:							
Commonwealth Government	14,159	-	-	-	-	-	14,159
Other funds	-	237,329	-	3,544	47,709	112,461	401,043
Unearned revenues							
Municipal license taxes	1,291,252	-	-	-	-	-	1,291,252
Intergovernmental - Federal grants	-	-	-	-	-	3,778	3,778
Total liabilities	1,739,434	779,749	208,252	948,145	609,006	181,637	4,466,223
Deferred Inflows of Resources:							
Unavailable revenues - Commonwealth Government Funds	935,948	-	2,771	-	-	32,681	971,400
Unavailable revenues - Federal grants	-	649,429	-	-	-	13,425	662,854
Unavailable revenues - Others	86,566	-	-	-	-	-	86,566
Total deferred inflow of resources	1,022,514	649,429	2,771	-	-	46,106	1,720,820
Fund balances (deficits):							
Restricted	-	-	81,036	973,009	1,970,382	135,324	3,159,751
Assigned	776,165	-	-	-	-	-	776,165
Unassigned	483,168	(646,395)	-	-	-	(94,614)	(257,841)
Total fund balances (deficits)	1,259,333	(646,395)	81,036	973,009	1,970,382	40,710	3,678,075
Total liabilities, deferred inflows of resources and fund balances (deficit)	\$ 4,021,281	\$ 782,783	\$ 292,059	\$ 1,921,154	\$ 2,579,388	\$ 268,453	\$ 9,865,118

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET POSITION
JUNE 30, 2013**

Total governmental fund balances: **\$ 3,678,075**

Amounts reported for governmental activities in the Statement of Net Position are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds: 41,341,080

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

Receivables:

Lease agreement	60,279	
Municipal licenses and sales tax	247,904	
Municipal properties rent	69,925	
Municipal other income	1,960	
Municipal permits	14,681	

Due from Commonwealth Government:

P.R. Department of Treasury - Christmas bonus reimbursement	88,622	
Commonwealth Legislature Resolutions	2,771	
P.R. Department of Education	9,190	
CRIM - Property tax final settlement	48,463	
P.R. Electric Power Authority (PREPA)	617,451	
P.R. Department of Family	29,592	

Due from Federal Government:

Federal Transit Administration	12,990	
Emergency Shelter Grant	435	
OCAM - CDBG and CDBG - ARRA	649,429	1,853,692

Interest liabilities are not due and payable in the current period and, therefore, are not reported in funds (81,816)

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

General obligation bonds and notes	(14,500,000)	
Note payable to CRIM-financing of delinquent accounts	(3,788)	
Compensated absences	(1,479,132)	
Christmas bonus payable	(177,245)	
Prior year property tax	-	
Estimated landfill closing costs	(1,324,211)	
P.R. Electric Power Authority (PREPA)	(617,450)	(18,101,826)

Net position of governmental activities: **\$ 28,689,205**

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES (DEFICIT) -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2013

	Major Funds						Total Governmental Funds
	General	Community Development Block Grant Program	Commonwealth Legislature Resolutions	Debt Service	Bonds and Note Issuance Fund	Other Governmental Funds	
Revenues:							
Taxes:							
Property taxes	\$ 1,971,872	\$ -	\$ -	\$ 817,607	\$ -	\$ -	\$ 2,789,479
Municipal license taxes	1,463,200	-	-	-	-	-	1,463,200
Sales and use taxes	1,603,196	-	-	520,422	-	-	2,123,618
Intergovernmental							
Commonwealth Government	3,881,869	-	100,553	-	-	279,490	4,261,912
Federal Government	-	812,104	-	-	-	1,332,221	2,144,325
Fees, fines and charges for services	2,832,502	2,111	-	6,346	-	33,606	2,874,565
Interest	5,398	-	-	2,463	50,352	-	58,213
Other	181,968	-	-	-	-	-	181,968
Total Revenues	11,940,005	814,215	100,553	1,346,838	50,352	1,645,317	15,897,280
Expenditures							
General government	6,050,738	96,504	-	227,972	-	238,440	6,613,654
Public works and sanitation	2,784,065	19,170	23,182	-	34,565	174,668	3,035,650
Public safety	862,897	-	-	-	-	93	862,990
Culture and recreation	834,673	-	-	-	-	-	834,673
Health	361,263	-	-	-	-	-	361,263
Housing, welfare and community development	630,117	120,766	49,535	-	-	1,236,482	2,036,900
Education	21,900	-	-	-	-	-	21,900
Capital outlays	358,056	755,952	134,488	-	631,980	68,512	1,948,988
Debt service:							
Principal	-	-	-	942,000	-	-	942,000
Interest	-	-	-	620,301	-	-	620,301
Bond issuance costs	-	-	-	-	9,282	-	9,282
Total expenditures	11,903,709	992,392	207,205	1,790,273	675,827	1,718,195	17,287,601
Excess (deficiency) of revenues over expenditures	36,296	(178,177)	(106,652)	(443,435)	(625,475)	(72,878)	(1,390,321)
Other financing sources (uses):							
Lease principal payments	76,152	-	-	-	-	-	76,152
Payment of long-term debt to PREPA	(531,907)	-	-	-	-	-	(531,907)
Proceeds from general obligation bonds	-	-	-	-	2,010,000	-	2,010,000
Transfers in	1,087,869	-	-	257,691	-	180,121	1,525,681
Transfers out	(437,812)	-	-	(1,037,517)	(50,352)	-	(1,525,681)
Total other financing sources (uses)	194,302	-	-	(779,826)	1,959,648	180,121	1,554,245
Net change in fund balances (deficit)	230,598	(178,177)	(106,652)	(1,223,261)	1,334,173	107,243	163,924
Fund balances (deficit) at beginning of year, as restated	1,028,735	(468,218)	187,688	2,196,270	636,209	(66,533)	3,514,151
Fund balances (deficit) at end of year	\$ 1,259,333	\$ (646,395)	\$ 81,036	\$ 973,009	\$ 1,970,382	\$ 40,710	\$ 3,678,075

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2013

Net change in fund balances (deficit) - total governmental funds:	\$	163,924
Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental funds reports capital assets 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:		
Expenditures for capital assets	\$ 1,952,960	
Less: current year depreciation	<u>(2,024,321)</u>	(71,361)
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net position differs from the change in fund balance by the cost of the disposed asset:		
		(131,978)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Receivables:		
Municipal licenses	1,656	
Sales tax	115,036	
Municipal properties rent	69,925	
Municipal other income	1,960	
Municipal permits	14,681	
Intergovernmental - Commonwealth Government		
P.R. Department of Treasury - Christmas bonus reimbursement (current)	88,622	
P.R. Department of Education	9,190	
CRIM - Property tax final settlement	48,463	
Commonwealth Legislature Resolutions	2,754	
P.R. Electric Power Authority (PREPA)	390,424	
P.R. Department of Family	29,592	
Intergovernmental - Federal Government		
OCAM - CDBG	491,717	
Federal Transit Administration	12,990	
Emergency Shelter Grant	<u>435</u>	1,277,445
Revenues reported in funds which are not reported as revenues in the Statement of Activities		
CRIM - Property tax preliminary settlement	(184,283)	
Sales and use tax	(604)	
P.R. Department of Treasury - Christmas bonus reimbursement (prior year)	(165,221)	
P.R. Department of Education	(10,673)	
P.R. Office of the Ombudsman for the Elderly - Titles III-D and E	(33,033)	
P.R. Department of Health - HOPWA	(2,782)	
P.R. Electric Power Authority (PREPA)	(336,694)	
P.R. Solid Waste Administration	(28,080)	
P.R. Infrastructure Financing Authority - PINI Funds	(1,386)	
OCAM - CDBG	(303,565)	
Emergency Shelter Grant	(7,317)	
P.R. Department of Housing - PRPHA	(2,537)	
Capital lease principal payment	<u>(67,484)</u>	(1,143,659)
Proceeds from general obligation bonds are other financing sources in the governmental funds, but increase in long-term liabilities in the Statement of Net Position:		
		(2,010,000)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		(51,000)
Repayment of long-term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Position:		
General Obligation Bonds and Notes	993,000	
Other Long-Term Liabilities	<u>1,012,005</u>	2,005,005
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 the governmental funds:		
Christmas Bonus	(177,245)	
P.R. Electric Power Authority (PREPA)	(585,636)	
Bond issuance costs	(87,376)	
Estimated landfill closing costs	(37,302)	
Compensated Absences	(317,864)	
Transfer of capital asset to PRASA	(5,042,532)	
Accrued interest (net change)	<u>5,595</u>	(6,242,360)
Change in net position of governmental activities:	\$	(6,203,984)

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Hormigueros was founded in 1874. The Municipality is governed by the executive and the legislative branch elected for a four-year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of twelve (12) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of the Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitute GAAP for governmental units.

1. Financial reporting entity

The financial reporting entity included in this report consists of the financial statements of the Municipality of Hormigueros (primary government) and organizations for which the primary government is financially accountable. In addition, the primary government may determine, through exercise of management's professional judgment, that the inclusion of an organization that does not meet the financial accountability criteria is necessary in order to prevent the reporting entity's financial statements from being misleading. Other entities should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. It is a matter of professional judgment to determine whether the nature and the significance of a potential component unit's relationship with the primary government warrant inclusion in the reporting entity. An entity should be considered a component unit if it meets any of the following three conditions:

- a. The primary government appoints a voting majority of the entity's governing body, and either:
 - A financial benefit/ burden exists between the primary government and the entity or
 - The primary government can impose its will on the entity.
- b. The entity is fiscally dependent on the primary government and there is a financial benefit/burden between the primary government and the entity.
- c. It would be necessary to include the entity as a component unit since the primary government's financial statements would be misleading without it.

In addition, "*special criteria*" apply when evaluating a legally separate, tax-exempt organization as potential component unit. Specifically, such entities must be treated as component units if they meet all of the following criteria:

- 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

- 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.

Legally separate, tax-exempt organizations that do not meet the above *special criteria* should still be included as a component unit if the financial statements of the primary government would be misleading without them.

There are two methods of presentation of the component unit in the financial statements: (a) *blending* the financial data of the component units' balances and transactions and (b) *discrete* presentation of the component unit's financial data. When a component unit functions as an integral part of the primary government, its data is *blended* with those of the primary government ("*blended component units*"). That is, the component unit's funds are treated just as though they were funds of the primary government with one exception: the general fund. Component units should be reported as *blended* if they meet any of the following criteria:

- a. The component unit's governing body is substantively the same as the governing body of the primary government and there is either:
- A financial benefit/ burden exists between the primary government and the entity or
 - Management of the primary government has operational responsibility for the primary government.
- b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government.
- c. The component unit's debt is expected to be paid by the primary government.

Otherwise, the component unit should be presented as discrete. Those component units does not function as an integral part of the primary government and its data is presented discretely (separately) from the data of the primary government ("*discretely component units*"). Legally separate, tax-exempt organizations that meet the *special criteria* should be included as *discretely component units*.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

2. Basis of presentation, measurement focus and basis of accounting

The financial report of the Municipality consists of the Management's Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Management's Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to the analysis the private sector provides in their annual reports.

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Government-wide statements

The government-wide statements consist of a Statement of Net Position and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which refers to the reporting of all of the net position available to the governmental unit for the purpose of providing goods and services to the public. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Position presents all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference reported as net position. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Direct expenses are those that are clearly identifiable with a specific function. As a policy, indirect expenses are not allocated in the Statement of Activities. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes and sales and use taxes (derived tax revenues) when the underlying exchange has occurred and time requirements are met. Revenues on both operating and capital grants are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met. For certain expenditure-driven grants, revenue is recognized after allowable expenditures are incurred.

The Municipality reports unearned revenues in the government-wide statements. Unearned revenues arise when resources are received before the Municipality has a legal claim to them (such as advances of derived tax revenues) or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for unearned revenues is removed from the Statement of Net Position and the revenue is recognized.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, deferred outflows, liabilities, deferred inflows, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official criteria if the fund is particularly important to financial statement users (for Commonwealth Legislature Resolutions Fund).

The Municipality reports the following major governmental funds:

General Fund: This is the operating fund of the Municipality and is used to account for and report all financial resources not accounted for and reported in another fund.

Community Development Block Grant Program (CDBG) Fund: CDBG fund is used to account for and report revenue sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. CDBG funds are received through the Office of Commissioner of Municipal Affairs ("OCAM"), a Commonwealth's governmental agency.

Commonwealth Legislature Resolutions Fund: This fund is used to account for and report revenue sources from grants provided by the Commonwealth's Legislature that are restricted, committed, or assigned for specific purposes which include, among others, acquisition, development and improvements of capital assets, public works, welfare and other community development projects.

Debt Service Fund: this fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditures for principal and interest. This fund accounts for the resources of three individual funds including the "Fondo 10 - CAE Fund" (sinking fund which accounts for the 2% of property taxes collected by the CRIM), "Fondo 11 - CRIM Fund" (resources transferred from general fund to CRIM for debt service) and the "Municipal Redemption Fund" (.2% of the .5% from sales and use taxes will be deposited in GDB to finance loans to Municipalities).

Bonds and Notes Issuance Fund: the Bonds and Notes Issuance Fund is used to account for and report financial resources from bond proceeds and notes issuance which are restricted for the acquisition or the construction of capital assets. This fund reports transactions of individual funds of Bonds and Notes issued through GDB.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The governmental fund financial statements are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. both measurable and available). Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Revenues susceptible to accrual include property taxes, recognized as revenues in the year for which they are levied; municipal license taxes and sales and use taxes, recognized when the underlying exchange has occurred and time requirements are met; and interest. In applying the susceptible to accrual concept to intergovernmental revenues, revenues are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met and revenue becomes available. There are, however, essentially two types of these revenues. In the first case, on expenditure-driven grants, monies must be expended on the specific project or purpose (eligibility requirement) before any amounts are paid to the Municipality. Revenue is, therefore, recognized as expenditures are incurred to the extent available. In the other cases, monies are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. In these cases revenues are recognized as the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports unearned revenues in the governmental funds statements. Unearned revenues arise when resources are received before the Municipality has a legal claim to them (such as advances of derived tax revenues) or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for unearned revenues is removed from the balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred as under accrual basis of accounting. Certain exceptions to this fundamental concept include the following: (1) payments of principal and interest on general long-term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) and (2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources. In the government-wide statements the expense and related accrual liability for long-term portions of debt must be included.

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Notes to Financial Statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Required Supplementary Information

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

3. *Deposits and investments*

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. Non-negotiable certificates of deposit with original maturity of more than three months are considered time deposits as required by current standards. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposit. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law.

The laws and regulations of the Commonwealth of Puerto Rico authorize the Municipality to invest only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by the Governmental Development Bank for Puerto Rico ("GDB"). Investment currently reported consist of a guaranteed investment contract ("GIC") managed by GDB. The GIC is valued at cost.

4. *Restricted assets*

Restricted assets are liquid assets which have third-party limitations on their use. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law.

Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property and sales tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of the other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

5. *Receivables and due from governmental entities*

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property and sales tax revenues of current fiscal year collected by the CRIM (property tax) and the Puerto Rico Department of Treasury (sales tax) on the subsequent fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

6. *Interfund receivables and payables*

Activities among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to 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 among funds are reported as "due from/to other funds".

7. *Inventories*

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes it is not significant.

8. *Capital assets*

Capital assets reported in the governmental activities in the Statements of Net Position include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items). The Municipality defines capital assets (except for infrastructure assets) as assets that have an individual cost of \$1,000 or more and have a useful life of one or more years. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. All capital assets, other than land and construction in progress, are depreciated using the straight-line method over the following useful lives:

<u>Description</u>	<u>Years</u>
Land improvements	20
Buildings and building improvements	20-50
Infrastructure	10-50
Vehicles, machinery and equipment	5-20

In accordance with current accounting standards capital assets are reviewed for impairment. Impairment occurs when there is a significant decline in asset service utility due to the occurrence of a prominent event or change in circumstances affecting the asset. Current standards provide guidance for accounting and reporting for impairment and for insurance recoveries.

9. *Deferred outflows/inflows of resources*

In addition to assets, the Statement of Net 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(s) and so will not be recognized as an outflow of resources (expense/ expenditure) until then.

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MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
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NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES- Continued

In addition to liabilities, the Statement of Net 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 government has only one item, which arises only under a modified accrual basis of accounting that qualifies for reporting in this category. Accordingly, the item, *unavailable revenue*, is reported only in the governmental funds balance sheet. The governmental funds report *unavailable revenue* from one source: unavailable intergovernmental revenues. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

10. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Position, consist of general and special obligation bonds, liabilities for compensated absences, and long-term liabilities to other governmental entities. Related bond issuance costs, whenever arise, are reported as current outflows of resources in the Statement of Activities, as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

11. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness). The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

12. Claims and judgments

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund when they mature (generally, when payment is due).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
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NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

13. Net position

In the government-wide statements, assets plus deferred outflows of resources less liabilities and deferred inflows of resources equal net position, and should be displayed in three components: net investment in capital assets, restricted, and unrestricted, as follows:

Net investment in capital assets:	Consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. The portion of the debt or deferred inflows of resources attributable to the unspent debt proceeds is not included in the calculation of net investment in capital assets. Instead, the portion of the debt or deferred inflows of resources is included in the same net position component (restricted or unrestricted) as the unspent amount.
Restricted net position:	The restricted component of net position consists of restricted assets (subject to restrictions beyond the Municipality's control) reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. Restrictions are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or imposed by the law through constitutional provisions or enabling legislation.
Unrestricted net position:	Unrestricted net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. Unrestricted net position is often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them.

14. Net position flow assumption

Sometimes the government will fund outlays for a particular purpose from both restricted (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 financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

COMMONWEALTH OF PUERTO RICO
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JUNE 30, 2013

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

15. Fund balances

GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions* (“GASB No. 54”) establishes accounting and reporting standards for all governments that report governmental funds. It also establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. These classifications comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints upon the use of the resources reported. The classifications are as follows:

- | | |
|----------------------|---|
| Nonspendable: | Amounts that cannot be spent because are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. |
| Restricted: | Amounts constrained by external parties (creditors, grantors, contributors, or laws and regulations of other governments), imposed by law through constitutional provisions or by enabling legislation. Enabling legislation authorizes the Municipality to assess, levy, charge or otherwise mandate payment or resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. Legal enforceability means that the Municipality can be compelled by an external party such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation. |
| Committed: | Amounts that can be used only for the specific purposes pursuant to constraints imposed through formal action (ordinance or resolution) by consent of the government’s highest level of decision-making authority, which in the case of the Municipality is the Mayor and the Municipal Legislature. Those committed amounts cannot be used for any other purposes unless the Mayor and the Municipal Legislature removes or changes the specified use by taking the same type of action (ordinance or resolution) it employed to commit those amounts. Formal action to commit fund balance to a specific purpose should occur prior to the end of the fiscal year, but the amount, if any, which will be subject to the constraint, may be determined in the subsequent period. |
| Assigned: | Amounts that are constrained by the Municipality’s intent to be used for specific purposes, but are neither restricted nor committed. In distinction to committed balances, the authority for making an assignment is not required to be the government’s highest level of decision-making authority (both the Mayor and the Municipal Legislature). It is the Municipality’s policy that intent can be expressed by the Mayor, the Finance Director (the official to which the Mayor has also delegated the authority to assign amounts) or by any other official or body to which the Mayor delegates. Furthermore, the nature of the actions necessary to remove or modify an assignment is not as prescriptive as it is with committed fund balances. With the exception of the general fund, this is the residual fund balance of the classification of all governmental funds with positive fund balances. Action taken to assign fund balances may be made after year-end. |
| Unassigned: | Is the residual classification for the general fund and includes all spendable amounts not restricted, committed or assigned. The general fund is the only fund that reports a positive unassigned fund balance amount. For all other governmental funds the unassigned classification is used only to report a deficit balance resulting for the overspending for specific purposes for which amounts had been restricted, committed or assigned. |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

16. Fund balance flow assumptions

Sometimes the government will fund outlays for a particular purpose from both restricted and unrestricted resources (the total of committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the governmental fund financial statements a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted fund balance to have been depleted before using any of the components of 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.

17. Interfund transactions

The Municipality reports certain transactions as transfers, which are legally required transfers that are reported when incurred as "Transfers-in" by the recipient fund and as "Transfers-out" by the disbursing fund.

18. Risk financing

The Puerto Rico Department of Treasury (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Hormigueros consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

19. Use of estimates

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

20. Reclassifications

Various reclassifications have been made in the accompanying basic financial statements which affect the comparability with the basic financial statements issued for previous fiscal years.

21. Future adoption of accounting pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

- a. ***GASB Statement No. 66*** "Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62". The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012 (fiscal year ended June 30, 2014).

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JUNE 30, 2013**

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- b. *GASB Statement No. 67* "*Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*". The provisions of this Statement are effective for financial statements for fiscal years beginning after June 15, 2013 (fiscal year ended June 30, 2014).
- c. *GASB Statement No. 68* "*Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*". The provisions of this Statement are effective for fiscal years beginning after June 15, 2014 (fiscal year ended June 30, 2015).
- d. *GASB Statement No. 69* "*Government Combinations and Disposals of Government Operations*". The provisions of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis (fiscal year ended June 30, 2015).
- e. *GASB Statement No. 70* "*Accounting and Financial Reporting for Nonexchange Financial Guarantees*". The provisions of Statement 70 are effective for fiscal year beginning after June 15, 2013 (fiscal year ended June 30, 2015).
- f. *GASB Statement No. 71* "*Pension Transition for Contributions Made Subsequent to the Measurement Date*". The provisions of this Statement should be applied simultaneously with the provisions of Statement 68 (fiscal year ended June 30, 2015).

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

NOTE B - DEPOSITS

1. Deposits

Custodial credit risk on Deposits - This is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name.

At year-end, the Municipality's bank balance of deposits in commercial banks amounting to \$2,769,290 was covered by federal depository insurance or by collateral held by the Secretary of Treasury of Puerto Rico in the Municipality's name. Deposits in governmental banks (all of which are uninsured and uncollateralized), are exposed to custodial credit risk. At year-end the Municipality's bank balance in governmental bank amounts to \$4,433,189.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE B – DEPOSITS - Continued

2. Investment

The investment held with fiscal agent consists of a non-participating guaranteed investment contract (“GIC”). This represents the investment of the undisbursed proceeds of the \$3,000,000 special obligation bond under custody of GDB, the Municipality’s fiscal agent, pursuant to the bond purchase agreement. The GIC has an outstanding balance of \$73,335 as of June 30, 2013. The GIC outstanding balance is valued at cost. This investment is exposed to credit risk, concentration of credit risk and interest rate risk. A description of these risks as of June 30, 2013 follows:

Credit Risk. The Municipality should provide information about the credit risk on investments by disclosing the credit quality ratings of investments as described by nationally recognized statistical rating organizations. As of June 30, 2013 the ratings are Baa3 for Moody’s and BBB- for Standard & Poor’s and Fitch. On February 2014 those ratings were downgraded to Ba2 by Moody’s, BB+ by Standard and Poor’s and BB by Fitch. See related Note T.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The GIC earns interest at a variable rate (.190% as of June 30, 2013), has an original maturity of 30 days and is due on July 10, 2013. This short-term maturity limits the decline in fair value. The Municipality does not have a formal policy for managing the interest rate risk besides investing its funds in barely non-risky instruments as required by the Office of Commissioner of Municipal Affairs (“OCAM”) rulings (Chapter V of “Reglamento de Normas Basicas de los Municipios de P.R.”).

Concentration of Credit Risk. The investment in GIC represents 100% of the Municipality’s total investments.

NOTE C – RECEIVABLES - LEASE

The Municipality is a lessor of a property, which consists of a building facility classified as direct financing lease. The lease term is for twenty years under a non-cancelable lease agreement. The following lists the component of the net investment in direct financing lease as of June 30, 2013:

	Amount
Total minimum lease payments to be received	\$ 63,460
Less: Unearned income	(3,181)
Net investment in direct financing lease	\$ 60,279

At June 30, 2013, minimum lease collections for the succeeding fiscal years are as follows:

Year	Amount
2014	\$ 57,114

**COMMONWEALTH OF PUERTO RICO
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NOTE D - DUE FROM GOVERNMENTAL ENTITIES

Amounts due from governmental entities as of June 30, 2013 follows:

	<u>Commonwealth Government</u>	<u>Federal Government</u>
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 617,450	\$ -
Municipal Revenue Collection Center (CRIM) – property taxes	48,463	-
P.R. Department of Treasury – Christmas bonus reimbursement	88,622	-
P.R. Department of Education – Student Transportation and CRASH 2013	19,100	-
P.R. Department of Treasury – sales and use taxes-Municipal Development Fund	27,172	-
<u>Major fund – CDBG fund:</u>		
Office of Commissioner of Municipal Affairs – CDBG	-	775,495
<u>Major fund – Commonwealth Legislature Resolutions fund:</u>		
Commonwealth Legislative Resolutions	30,676	-
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – property taxes	17,008	-
P.R. Department of Treasury – sales and use taxes-Municipal Redemption Fund	58,619	-
<u>Other governmental funds:</u>		
Home Caregivers	29,591	-
P.R. Department of Family - Emergency Solutions Grant Program	-	12,990
Federal Transit Administration	-	12,990
U.S. Department of Housing and Urban Development – Section 8 HCVF	-	6,940
P.R. Department of Education - Child Care Food Program	-	4,624
Others	6,558	-
	<u>\$ 943,259</u>	<u>\$ 813,039</u>

Certain amounts are recorded as deferred inflows of resources in the governmental funds statements since they are not available as required by current standards. See related note J.

NOTE E - INTERFUND TRANSACTIONS

1. Due from/to other funds

Amounts due from/to other funds represent temporary advances to other funds by the general fund to finance payroll, payroll taxes and other expenditures, as follows:

<u>Receivable Fund</u>	<u>Payable Funds</u>	<u>Amount</u>
General Fund	<u>Major fund:</u>	
	CDBG	\$ 237,329
	<u>Major fund:</u>	
	Debt Service	3,544
	<u>Major fund:</u>	
	Bonds and Notes Issuance Fund	47,709
	<u>Other Governmental Funds</u>	
	Public Housing	800
	Emergency Shelter Grant Program	13,461
	HOPWA	4,566
	Home Caregivers	18,851
	Schools Maintenance	9,777
	Law 52	45,563
	Title III	12,940
	FTA	5,322
	Others	1,181
Total:		<u>\$ 401,043</u>

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JUNE 30, 2013**

NOTE E - INTERFUND TRANSACTIONS – Continued

2. Transfers in (out)

Transfers among individual funds were made for operational purposes. Transfers include (1) interest earned on restricted cash and cash with fiscal agent in the Debt Service, Commonwealth Legislative Resolutions and Bonds and Notes Issuance Funds which were transferred to the general fund, (2) transfers from the general fund to other governmental funds to provide resources for certain governmental fund's activities, and (3) transfers from the General fund to the Debt Service Fund for the repayment of debt.

NOTE F- FUND BALANCE

1. Fund balance classifications

The governmental fund balance classifications and amounts at June 30, 2013 are shown in the following table:

	General Fund	Community Development Block Grant Program	Commonwealth Legislative Resolutions	Debt Service	Bonds and Notes Issuance	Other Governmental Funds	Total
Restricted:							
General public works and sanitation	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 9,057	\$ 9,057
Public safety	-	-	-	-	-	3,977	3,977
Housing, welfare and community development	-	-	-	-	-	66,963	66,963
Debt service	-	-	-	973,009	-	-	973,009
Capital outlays	-	-	81,036	-	1,969,723	55,327	2,106,086
General government and other purposes	-	-	-	-	659	-	659
	<u>-</u>	<u>-</u>	<u>81,036</u>	<u>973,009</u>	<u>1,970,382</u>	<u>135,324</u>	<u>3,159,751</u>
Assigned:							
General public works and sanitation	38,813	-	-	-	-	-	38,813
Public safety	820	-	-	-	-	-	820
Sports, culture and recreation	4,631	-	-	-	-	-	4,631
Health	42	-	-	-	-	-	42
Housing, welfare and community development	4,100	-	-	-	-	-	4,100
Capital outlays	669,054	-	-	-	-	-	669,054
General government and other purposes	58,705	-	-	-	-	-	58,705
	<u>776,165</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>776,165</u>
Unassigned	483,168	(646,395)	-	-	-	(94,614)	(257,841)
	<u>\$ 1,259,333</u>	<u>\$ (646,395)</u>	<u>\$ 81,036</u>	<u>\$ 973,009</u>	<u>\$ 1,970,382</u>	<u>\$ 40,710</u>	<u>\$ 3,678,075</u>

2. Fund balance deficits

Certain special funds included in the fund statements disclosed fund balance deficits as follows:

Funds	Fund balance – unassigned amount
Major Funds:	
Community Development Block Grant Program	\$ 646,395
Other Governmental Funds:	
P.R. Department of Labor – Law No. 52	\$ 41,257
P.R. Office of Ombudsman Administration (OAP)	19,814
Home Caregivers	19,930
FTA	5,146
Others	8,467
	<u>\$ 94,614</u>

**COMMONWEALTH OF PUERTO RICO
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JUNE 30, 2013**

NOTE F- FUND BALANCE - Continued

The deficits result from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental revenues for reimbursement (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

NOTE G- CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2013 is as follows:

	<u>Balance July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2013</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 8,232,361	\$ 31,501	\$ -	\$ 8,263,862
Construction in progress	8,050,541	1,064,979	7,473,027	1,642,493
Total capital assets not being depreciated:	16,282,902	1,096,480	7,473,027	9,906,355
Capital assets, being depreciated:				
Land improvements	1,687,506	-	-	1,687,506
Buildings and building improvements	30,557,436	2,652,710	-	33,210,146
Infrastructure	12,089,815	553,057	149,289	12,493,583
Vehicles, machinery and equipment	8,444,747	81,208	640,413	7,885,542
Total capital assets being depreciated	52,779,504	3,286,975	789,702	55,276,777
Less accumulated depreciation for:				
Land improvements	504,362	82,092	-	586,454
Buildings and building improvements	9,238,978	878,800	-	10,117,778
Infrastructure	6,666,078	595,844	107,966	7,153,956
Vehicles, machinery and equipment	6,066,036	467,585	549,757	5,983,864
Total accumulated depreciation	22,475,454	2,024,321	657,723	23,842,052
Total capital assets being depreciated, net	30,304,050	1,262,654	131,979	31,434,725
Governmental activities capital assets, net	<u>\$ 46,586,952</u>	<u>\$ 2,359,134</u>	<u>\$ 7,605,006</u>	<u>\$ 41,341,080</u>

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

Governmental activities:

General government	\$ 207,959
Public works and sanitation	779,911
Public safety	144,047
Culture and recreation	647,777
Health	9,964
Welfare and community development	143,498
Education	91,165
Total depreciation expense, governmental activities	<u>\$ 2,024,321</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE G- CAPITAL ASSETS – Continued

The Municipality entered into agreements with agencies and instrumentalities of the Commonwealth to perform the construction of certain infrastructure projects to be ultimately used by those agencies and instrumentalities in their operations. These capital projects (including land acquired) are funded by the Municipality through grants and/or loans and included as part of the Municipality's capital assets until construction is completed and conditions for transfers to the ultimate beneficiaries are met. At that time, they are recorded as an expense in the Statement of Activities. During the fiscal year 2012-2013 the Municipality transferred to the Puerto Rico Aqueduct and Sewer Authority ("PRASA") "Lavadero Sanitary Sewer System," an infrastructure project amounting to \$5,042,532 after conditions for transfers were met, including an inspection from PREPA's officials. Total project cost transferred was recorded as public works expense in the Statement of Activities.

NOTE H- LONG-TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2013:

	<u>Balance at July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2013</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 14,191,000	\$ 2,010,000	\$ 993,000	\$ 15,208,000	\$ 953,000
Note payable to CRIM- financing of delinquent accounts	3,987	-	199	3,788	199
Compensated absences	1,343,806	317,864	182,538	1,479,132	200,961
Christmas Bonus	207,504	177,245	207,504	177,245	177,245
Estimated Landfill Closing Costs	1,286,909	37,302	-	1,324,211	-
Payable to CRIM- property tax advances	89,858	-	89,858	-	-
Payable to PREPA	563,720	585,636	531,906	617,450	422,238
	<u>\$ 17,686,784</u>	<u>\$ 3,128,047</u>	<u>\$ 2,005,005</u>	<u>\$ 18,809,826</u>	<u>\$ 1,753,643</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2013 amount to \$15,208,000. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law. Debt service fund has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
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JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

Principal and interest payments of certain long-term debt issued for operational purposes (special obligation notes of \$3,000,000 and \$203,000) are made through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Principal and interest payments of special obligation notes of \$305,000; \$139,000; \$1,027,000, \$385,000 and \$2,010,000 are made through the “Municipal Redemption Fund (IVU)”. A detail of the general and special obligation bonds and notes as of June 30, 2013 follows:

	Outstanding Amount
1994 public improvement bonds of \$125,000 due in annual installments of \$3,000 to \$10,000 through January 1, 2019; bearing interest at 5%	\$ 48,000
1992 public improvement bonds of \$168,000 due in annual installments of \$2,000 to \$17,000 through January 1, 2017; bearing interest at 5%	57,000
1997 general obligation bonds of \$175,000 due in annual installments of \$5,000 to \$15,000 through July 1, 2021; bearing interest at rates ranging from 4.865% to 6.56% (6.11% at June 30, 2013)	95,000
1996 general obligation bonds of \$390,000 due in annual installments of \$5,000 to \$40,000 through July 1, 2020; bearing interest at rates ranging from 4.70% to 6.63% (6.58 % at June 30, 2013)	215,000
1999 general obligation bonds of \$410,000 due in annual installments of \$5,000 to \$35,000 through July 1, 2024; bearing interest at rates ranging from 2.70% to 7.81% (4.61% at June 30, 2013)	280,000
2001 general obligation bonds of \$425,000 due in annual installments of \$5,000 to \$40,000 through July 1, 2025; bearing interest at rates ranging from 2.70% to 6.13% (4.61% at June 30, 2013)	315,000
1999 general obligation bonds of \$736,000 due in annual installments of \$19,000 to \$52,000 through January 1, 2024; bearing interest at 4.75%	459,000
1998 general obligation bonds of \$983,000 due in annual installments of \$23,000 to \$65,000 through January 1, 2024; bearing interest at 4.5%	579,000
2002 general obligation bonds of \$1,000,000 due in annual installments of \$21,000 to \$65,000 through January 1, 2030; bearing interest at 4.50%	790,000
2000 general obligation bonds of \$1,040,000 due in annual installments of \$27,000 to \$76,000 through January 1, 2025; bearing interest at 5.12%	702,000
1997 general obligation bonds of \$1,538,000 due in annual installments of \$41,000 to \$109,000 through January 1, 2022; bearing interest at 4.75%	821,000
2004 general obligation bonds of \$530,000 due in annual installments of \$15,000 to \$40,000 through July 1, 2024; bearing interest at rates ranging from 3.28% to 5.28% (4.36% at June 30, 2013)	375,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

	<u>Outstanding Amount</u>
2004 general obligation bonds of \$1,355,000 due in annual installments of \$35,000 to \$85,000 through July 1, 2029; bearing interest at rates ranging from 3.28% to 5.31% (4.36% at June 30, 2013)	1,040,000
2006 general obligation bonds of \$920,000 due in annual installments of \$20,000 to \$70,000 through July 1, 2030; bearing interest at rates ranging from 4.17% to 5.31% (4.36% at June 30, 2013)	770,000
2007 general obligation bonds of \$840,000 due in annual installments of \$10,000 to \$75,000 through July 1, 2031; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	750,000
2007 general obligation notes of \$525,000 due in annual installments of \$60,000 to \$90,000 through July 1, 2014; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	175,000
2008 general obligation notes of \$400,000 due in annual installments of \$45,000 to \$70,000 through July 1, 2014; bearing interest at rates ranging from 1.53% to 7.25% (1.53% at June 30, 2013)	135,000
2008 general obligation bonds of \$569,000 due in annual installments of \$40,000 to \$77,000 through July 1, 2017; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	336,000
2008 special obligation notes of \$305,000 due in annual installments of \$45,000 to \$60,000 through July 1, 2014; bearing interest at rates ranging from 1.53% to 5.00% (1.53% at June 30, 2013)	115,000
2008 special obligation notes of \$139,000 due in annual installments of \$2,000 to \$11,000 through July 1, 2032; bearing interest at rates ranging from 1.53% to 7.25% (1.53% at June 30, 2013)	130,000
2008 special obligation notes of \$1,027,000 due in annual installments of \$16,000 to \$87,000 through July 1, 2032; bearing interest at rates ranging from 1.53% to 7.25% (1.53% at June 30, 2013)	957,000
2007 special obligation bond of \$3,000,000 due in annual installments of \$60,000 to \$205,000 through July 1, 2032; bearing interest at 5.83%	2,655,000
2007 special obligation bond of \$203,000 due in annual installments of \$14,000 to \$27,000 through July 1, 2017; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	119,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

	<u>Outstanding Amount</u>
2008 special obligation notes of \$385,000 due in annual installments of \$5,000 to \$30,000 through July 1, 2033; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	365,000
2010 general obligation bonds of \$510,000 due in annual installments of \$35,000 to \$65,000 through July 1, 2019; bearing interest at rates ranging from 6.00% to 6.50% (6.00% of June 30, 2013)	390,000
2010 general obligation bonds of \$285,000 due in annual installments of \$5,000 to \$25,000 through July 1, 2034; bearing interest at rates ranging from 6.00% to 6.50% (6.00% at June 30, 2013)	270,000
2010 general obligation notes of \$160,000 due in annual installments of \$15,000 to \$30,000 through July 1, 2016; bearing interest at rates ranging from 6.0% to 7.50% (6.00% at June 30, 2013)	105,000
2010 municipal obligation notes of \$235,000 due in annual installments of \$25,000 to \$40,000 through July 1, 2016; bearing interest at rates ranging from 6.0% to 6.50% (6.00% at June 30, 2013)	150,000
2013 special obligation bond of \$,2010,000 due in annual installments of \$30,000 to \$175,000 through July 1, 2037; bearing interest at rates ranging from 6.0% to 7.50% (6.00% at June 30, 2013)	2,010,000
	<u>\$ 15,208,000</u>

Annual requirements to amortize general and special obligation bonds and notes as of June 30, 2013 are as follows:

June 30,	Principal	Interest
2014	\$ 953,000	\$ 814,471
2015	1,000,000	802,652
2016	842,000	754,231
2017	890,000	702,627
2018	851,000	1,341,208
2019-2023	3,931,000	2,604,836
2024-2028	3,119,000	1,571,803
2029-2033	2,807,000	649,846
2034-2038	815,000	122,000
Totals	<u>\$ 15,208,000</u>	<u>\$ 9,363,674</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

3. Other long-term liabilities

		<u>Outstanding Amount</u>																														
<p>Note payable to CRIM (Financing of delinquent accounts) - On March 19, 2002 the Municipality entered into a financing agreement with the CRIM in the amount of \$158,431 to finance delinquent property tax accounts sold to private investors, under the provisions of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving line of credit bearing interest of 6.5% for the first five years and variable for the next twenty-five years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first five years were financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first five years any collection from those delinquent accounts was credited to the loan principal. After the five-year period the loan outstanding balance was restructured for a twenty-five year period. The amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of the municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center. Debt service requirements in future years are as follows:</p>																																
<table style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="border-bottom: 1px solid black; padding: 2px;">June 30,</th> <th style="border-bottom: 1px solid black; padding: 2px;">Principal</th> <th style="border-bottom: 1px solid black; padding: 2px;">Interest</th> </tr> </thead> <tbody> <tr> <td style="padding: 2px;">2014</td> <td style="padding: 2px;">\$ 199</td> <td style="padding: 2px;">\$ 232</td> </tr> <tr> <td style="padding: 2px;">2015</td> <td style="padding: 2px;">199</td> <td style="padding: 2px;">220</td> </tr> <tr> <td style="padding: 2px;">2016</td> <td style="padding: 2px;">199</td> <td style="padding: 2px;">208</td> </tr> <tr> <td style="padding: 2px;">2017</td> <td style="padding: 2px;">199</td> <td style="padding: 2px;">195</td> </tr> <tr> <td style="padding: 2px;">2018</td> <td style="padding: 2px;">199</td> <td style="padding: 2px;">183</td> </tr> <tr> <td style="padding: 2px;">2019-2023</td> <td style="padding: 2px;">997</td> <td style="padding: 2px;">728</td> </tr> <tr> <td style="padding: 2px;">2024-2028</td> <td style="padding: 2px;">997</td> <td style="padding: 2px;">419</td> </tr> <tr> <td style="padding: 2px;">2029-2032</td> <td style="padding: 2px;">800</td> <td style="padding: 2px;">112</td> </tr> <tr> <td style="padding: 2px; border-top: 1px solid black;">Totals</td> <td style="padding: 2px; border-top: 1px solid black; border-bottom: 3px double black;">\$ 3,788</td> <td style="padding: 2px; border-top: 1px solid black; border-bottom: 3px double black;">\$ 2,297</td> </tr> </tbody> </table>	June 30,	Principal	Interest	2014	\$ 199	\$ 232	2015	199	220	2016	199	208	2017	199	195	2018	199	183	2019-2023	997	728	2024-2028	997	419	2029-2032	800	112	Totals	\$ 3,788	\$ 2,297	\$	3,788
June 30,	Principal	Interest																														
2014	\$ 199	\$ 232																														
2015	199	220																														
2016	199	208																														
2017	199	195																														
2018	199	183																														
2019-2023	997	728																														
2024-2028	997	419																														
2029-2032	800	112																														
Totals	\$ 3,788	\$ 2,297																														
<p>Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time; represents the Municipality's commitment to fund such costs from future operations. The amount is paid with unrestricted funds.</p>	\$	1,479,132																														
<p>Christmas Bonus - represents the accrued portion corresponding to fiscal year 2013 of the Christmas bonus to be paid in December 2013 with unrestricted funds.</p>	\$	177,245																														

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

	Outstanding Amount
<p>Estimated closure and post-closure care costs of Municipal Landfill - The Municipality owns and operates a MSW landfill in Barrio Jaguitas, Hormigueros since about 1977. The Municipality has recognized an estimated liability for future closure and post-closure care costs. (See Note I)</p>	<p>\$ 1,324,211</p>
<p>Payable to PREPA - As required by Act No. 83 of May 2, 1941 the Puerto Rico Electric Power Authority ("PREPA") should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax ("CELI") based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For fiscal year 2011-2012 the Municipality's annual energy charges amounted to \$1,512,085 but the CELI obligation amounted to \$926,449. The excess amount of \$585,636 was recorded as a payable and a receivable for the same amount and will be amortized over a three-year period. As of June 30, 2013 the outstanding amount of \$617,450 includes the unamortized balances of \$390,424 and \$227,026 from fiscal years 2012 and 2011, respectively, and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:</p>	<p>\$ 617,450</p>

June 30	Principal
2014	\$ 422,238
2015	195,212
Totals	\$ 617,450

NOTE I - LANDFILL CLOSURE AND POST-CLOSURE CARE COSTS OBLIGATIONS

The Municipal operates a landfill since 1977. Commonwealth and Federal laws and regulations require the Municipality to place a final cover on its landfill when it stops accepting waste and perform certain maintenance and monitoring functions at the landfill site for thirty years after closure. In addition to operating expenses related to current activities of the landfill, an expense provision and related liability should be recognized based on the future closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste. The Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to comply with applicable laws and regulations.

As a result of this study, the Municipality has recognized an estimated liability for future closure and post-closure care costs. The recognition of this liability is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a balance of \$1,324,211 as of June 30, 2013, which is based on 58% usage of the landfill. It is estimated that an additional \$839,288 will be recognized as closure and post-closure care expenditures between the date of the balance sheet and the date the landfill is expected to be filled to capacity (December 2035). The estimated total current costs of the landfill closure and post-closure care (\$2,163,499) is based on the amount that would be paid if all the equipment, facilities and services required to close, monitor and maintain the landfill were acquired as of June 30, 2013. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE J- DEFERRED INFLOWS OF RESOURCES – GOVERNMENTAL FUNDS

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

	<u>Commonwealth Government Funds</u>	<u>Federal Grants</u>	<u>Others</u>
<u>Major fund – General fund:</u>			
P.R. Electric Power Authority (PREPA)	\$ 617,450	\$ -	\$ -
Municipal Revenue Collection Center (CRIM)- property taxes and intergovernmental subsidy(general fund)	48,463	-	-
P.R. Department of Treasury – Christmas bonus reimbursement	88,622	-	-
P.R. Department of Education	778	-	-
Municipal Sales Tax Revenue	115,035	-	-
Lease Payments	60,278	-	-
Rent	5,322	-	69,925
Construction excise taxes	-	-	14,681
Other	-	-	1,960
<u>Major fund – CDBG fund:</u>			
Office of Commissioner of Municipal Affairs – CDBG	-	649,429	-
<u>Major fund – Legislature Resolutions Fund</u>			
Legislature Resolutions	2,771	-	-
<u>Other governmental funds:</u>			
Home Caregivers	29,591	-	-
Federal Transit Administration	-	12,990	-
Others	3,090	435	-
	<u>\$ 971,400</u>	<u>\$ 662,854</u>	<u>\$ 86,566</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE K – PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2013 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

<u>Description</u>	<u>Personal Property</u>	<u>Real Property</u>
Basic property tax rate, which is appropriated for general purposes and accounted in the Municipality's general fund	4.00%	6.00%
Percent that belongs to the Commonwealth's debt service fund	1.03%	1.03%
Percent that belongs to the Municipality's debt service fund	2.00%	2.00%
Total tax rate	7.03%	9.03%
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department	(.20%)	(.20%)
Total percent to be paid by taxpayers	<u>6.83%</u>	<u>8.83%</u>

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. 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. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. A receivable of \$48,463 from the final settlement of fiscal 2012-2013 was recorded as deferred inflows of resources since it is not available as required by current standards.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE L – MUNICIPAL LICENSE TAXES

Municipal License taxes are assessed annually by the Municipality to all organizations or entities doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15.

During the fiscal year ended June 30, 2013, the tax rates were as follows:

Financial business – 1.50% of gross revenues
Other organizations - .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$1,291,252 is recorded as unearned revenues.

NOTE M – SALES AND USE TAXES

1. As of June 30, 2013

On July 4, 2006 the Commonwealth Legislature approved Act No. 117 ("Act 117"), which amends the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a sale and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sale and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax. The Municipal Legislature approved the imposition of the municipal sales and use tax effective on November 15, 2006.

On July 29, 2007 the Commonwealth Legislature approved Act No. 80 ("Act 80") which amends Act No. 117 of July 4, 2006 to impose to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007, 1% of the 1.5% is collected by the Municipalities and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of Treasury (PRDT).

The amount collected by the PRDT (.5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

- a. .2% of the .5% will be deposited in a "Municipal Development Fund" to be distributed among all the municipalities in accordance with a formula created by the Act,
- b. .2% of the .5% will be deposited in a "Municipal Redemption Fund" to finance loans to municipalities and,
- c. .1% of the .5% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE M – SALES AND USE TAXES – Continued

The Municipal Legislature approved a municipal ordinance to conform to dispositions of Act 80. Effective January 1, 2011 the Commonwealth of Puerto Rico adopted a new Internal Revenue Code (“2011 PR Code”). Subtitle D (Sections 4010 to 4070) of the 2011 PR Code incorporates the dispositions applicable to the sales and use tax. As stated by Section 4050, the municipalities may use the sales and use tax proceeds to finance solid waste, recycling, capital projects, health and public safety programs as well as any other activity that promotes sound public administration.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the PRDT. The tax is due the 10th day of each month based on tax collected in the preceding month. The Municipality recorded as revenue \$1,603,196 in the general fund (of which \$ 1,267,426 corresponds to the 1% imposition and \$335,770 corresponds to the Municipal Development Fund) and \$520,422 in the debt service fund corresponding to the Municipal Redemption Fund.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due the 10th day of each month based on the tax collected in the preceding month. A total of \$222,191 sales and use tax receivable represents the tax collected on June by individuals, organizations and entities but reported and paid to the Municipality on or before July 10, net of uncollectible accounts; \$27,173 and \$58,619 represents amounts of “Municipal Development Fund” and “Municipal Redemption Fund”, respectively, collected on June by individuals, organizations and entities but paid by the PRDT subsequent to June 30, 2013.

On June 30, 2013 the Commonwealth approved Act No. 40 which, among other things, reduces the municipal sales and use tax from 1.5% to 1% and increases the Commonwealth sales and use tax from 5.5% to 6% effective December 1, 2013. This Act was subsequently amended to change this effective date from December 1, 2013 to February 1, 2014. In addition, subsequent to June 30, 2013 the Commonwealth approved Acts No. 18 and 19 of January 24, 2014 for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long-term debt issuances. See related Note T.

NOTE N – INTERGOVERNMENTAL REVENUES AND FEES, FINES AND CHARGES FOR SERVICES - GENERAL FUND

I. Intergovernmental revenues in the General Fund are comprised of the following:

	<u>Amount</u>
Amount of municipal equalization fund sent by CRIM	\$ 3,638,042
Reimbursement from P.R. Department of Treasury - Christmas Bonus reimbursement	158,253
Infrastructure fund	22,442
FE “Bellas Artes”	23,885
Other	39,247
	<u>\$ 3,881,869</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

**NOTE N – INTERGOVERNMENTAL REVENUES AND FEES, FINES AND CHARGES FOR SERVICES
- GENERAL FUND - Continued**

2. Fees, fines and charges for services revenues reported in the general fund are comprised of the following:

	Amount
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	\$ 1,876,558
P.R. Department of Education – transportation services to students	227,347
Construction excise tax	154,138
Rental income	434,204
Licenses and permits	5,945
Fines	4,773
Land lot sales	70,085
Solid waste disposal	35,138
Other	24,314
	\$ 2,832,502

NOTE O – RETIREMENT PLAN

1. Plan description

As of June 30, 2013 regular employees of the Municipality contribute to a cost-sharing multiple employer defined benefit retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full-time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and non-occupational disabilities. Benefits vest after ten years of plan participation.

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

Act No. 305 of September 24, 1999 amended *Act No. 447 of 1951* and *Act 1 of February 16, 1990* to establish a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE O – RETIREMENT PLAN – Continued

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets which will be invested by the System together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If the savings account balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions have not been granted under the new program. The employer contributions (11.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600, except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary.

As of June 30, 2012, the ERS has an unfunded actuarial accrued liability of approximately \$26.4 billion. In the opinion of management if measures are not implemented to deal with this situation, the ERS's net assets will be exhausted by fiscal year 2015. In order to address this issue, among other measures, on July 6, 2011(effective July 1, 2011) the Commonwealth Legislature approved Act No. 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for fiscal year 2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The purpose of this Act is to provide cash flow and strengthen the System to adequately cover administrative expenses and payment of benefits.

The Municipality is required to contribute 11.275% of gross salary for fiscal year 2013. As stated in the Act, percent increases applicable to municipalities for fiscal years 2011-2012, 2012-2013 and 2013-2014 would be financed through the Commonwealth's budget approved by the Commonwealth's Legislature. The Municipality's actual contribution for Law 447 and System 2000 are \$326,019, \$347,530, and \$359,848 for the years ended on June 30, 2013, 2012, and 2011, respectively.

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3, representing a comprehensive reform of the ERS. See related Note T.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE P – POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note O, as of June 30, 2013 the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth laws. Also, the Municipality is required to finance costs related to the application of certain “Special Laws” issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicine bonus, Christmas bonus and death benefits. For fiscal year 2013, costs related to these post-employment benefits amounted to \$99,891. These benefits are recorded as expenditures in the general fund.

NOTE Q – COMMITMENTS

1. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less, and are automatically renewed for the same terms. Rental expenses amounted to \$154,869. Management believes that the summary of the future minimum rental commitments under non-cancelable operating leases with terms exceeding one year is not significant.

2. Construction

As of June 30, 2013 the Municipality has commitments of \$445,182 for design, construction, improvements or renovation of certain municipal facilities.

3. Encumbrances

The Municipality has encumbrances outstanding which represent the estimated amount of expenditures required to complete contracts, purchase orders and other commitments in process of completion at fiscal year-end. Outstanding encumbrances as of June 30, 2013 in the general fund represent unassigned amounts that are encumbered and are classified by management as assigned fund balance. Purpose classification follows:

Purpose	General Fund- assigned fund balance
General public works and sanitation	\$ 28,448
Public safety	199
Sports, Culture and recreation	4,403
Housing, welfare and community development	4,100
Health	42
General government and other purposes	13,533
	\$ 50,725

The fund balance of major and other governmental funds (special revenue, capital project and debt service fund) is classified as restricted, some or all of which may be encumbered. Encumbrances of restricted fund balances are not reported separately from this classification because the encumbrance does not further restrict the purpose for which the resources may be used.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE R – CONTINGENCIES

1. Federal and Commonwealth Grants

Projects financed by the Federal and Commonwealth Grants are subject to audits by grantors and other governmental agencies in order to determine that the expenditures complies with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to be performed.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that would not be covered by insurance. However, it is the opinion of the Municipality and legal counsel that, based on their experience, such actions and the potential liabilities will not impair the Municipality's financial position.

NOTE S – RESTATEMENT OF FUND BALANCE AND NET POSITION

The following table disclosed the net change in fund balances and net position at beginning of year as previously reported in the financial statements. The beginning balances have been restated as follows:

<u>Description</u>	<u>Fund Balance</u>	<u>Net Position</u>
	<u>General Fund</u>	<u>Government-Wide Statements</u>
Fund balance / net position, at beginning of year, as previously reported	\$ 1,288,509	\$ 35,152,963
Correction of error, recording of cash book balance in the general fund	(259,774)	(259,774)
Fund balance / net position, at beginning of year, as restated	<u>\$ 1,028,735</u>	<u>\$ 34,893,189</u>

NOTE T – SUBSEQUENT EVENTS

The Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit rating agencies have been consistently downgrading the Commonwealth's and certain public corporation's general obligation bond ratings. In order to address these matters the Commonwealth began to enact legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico ("GDB"), its fiscal agent, and strengthen sinking funds to assess financial markets. The Commonwealth estimates that the following corrective actions, among others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE T – SUBSEQUENT EVENTS – Continued

1. Pension System Reform

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

- a. Moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new hybrid plan (“New Plan”).
- b. 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 New Plan. Participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.
- c. Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual’s life expectancy and a rate of return.
- d. New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees’ contributions plus a return on investment)
- e. Eliminates the possibility of accruing a merit pension (payable once the participant has achieved 30 years of creditable service) after June 30, 2013.
- f. Increases employee contributions from 8.275% to a minimum of 10%.
- g. After July 1, 2013 all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016 an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. These contributions will be used to increase the System’s assets, reduce the actuarial deficit and enable the System to comply with future obligations.
- h. Retirement age will be modified as follows:
 - 1) Act 447 regular employees: age 58 to 61,
 - 2) Act 447 high risk employees (state and municipal police, firefighters and custody officials): from age 50 to 55 years,
 - 3) Act 305 (System 2000) regular employees: age 60 to 65; high risk employees remains the same (55 years).

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE T – SUBSEQUENT EVENTS - Continued

- i. Modifies Special Law benefits as follows:
 - 1) Reduction in Christmas bonus from \$600 to \$200 (current retirees),
 - 2) Elimination of summer bonus of \$100 (current retirees),
 - 3) No change in medical plan contribution of up to \$1,200 and medicine bonus of \$100 (current retirees)
 - 4) Eliminates Special Law benefits to future retirees.

Employers will contribute \$2,000 per retiree and future retiree (originally under Act 447 and Act 1); the System will benefit from the savings generated between this employer contribution and the Special Law benefits paid out to retirees.

- j. Given these changes to Special Laws, the minimum monthly pension for current retirees was increased from \$400 to \$500.
- k. Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.
- l. Survivor benefits will be modified.

In addition to the previously scheduled measures, the ERS reform plan also assumes an estimated \$140 million incremental contribution from the general fund (1.4% of general fund expenses for fiscal year 2014) to be included in the Commonwealth's proposed budget for fiscal year 2014 and thereafter. The Commonwealth projects that the combined impact of these measures will allow the retirement system to increase the liquidity and solvency and meet the revised future obligations.

2. Sales and use taxes – Act No. 18 and 19 of 2014

In order to address the fiscal and credit crisis of the Commonwealth of Puerto Rico, the GDB liquidity and the difficult fiscal situation of the municipalities of Puerto Rico, on January 24, 2014 the Commonwealth approved Acts No. 18 and 19. Those Acts provide for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long-term debt issuances. As a result of this legislation the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

a. Act No. 18 of January 24, 2014

The purpose of this Act is to create a special fund called "Municipal Administration Fund" ("FAM") under custody of the Governmental Development Bank of Puerto Rico ("GDB") that permits the municipalities to guarantee and pay long-term debt and provide funds for its general operations. In addition, this Act improves the financing capacity of the Puerto Rico Sales Tax Financing Corporation ("COFINA"), a Commonwealth fund administered by GDB and the P.R. Secretary of Treasury. The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE T – SUBSEQUENT EVENTS – Continued

The 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds during a transitory period from February 1, 2014 to June 30, 2014, the Commonwealth will deposit \$43,440,184 in the FAM to be distributed to the Municipalities as follows:

- .2% will be deposited in a "Municipal Development Fund" to be distributed to the municipalities,
- .2% will be deposited in a "Municipal Redemption Fund" to guarantee and repay the municipalities long-term debt and,
- .1% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

After July 1, 2014 the 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds the Commonwealth will deposit .5% in the FAM. Distribution to municipalities will depend on whether the municipalities signed an agreement to be covered or not covered by the Act's provisions. The Municipality of Hormigueros signed the agreement to be covered.

For municipalities covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the "Municipal Development Fund" to be distributed to the municipalities,
- .2% will be deposited in a "Municipal Redemption Fund" and then be deposited in the municipalities general fund. The municipalities have the option to maintain funds in the "Municipal Redemption Fund" or to transfer funds from the "Municipal Development Fund" to increase its debt margin and issue loans to be obtained from financial institutions,
- .1% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

For municipalities not covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the "Municipal Development Fund". Section 4 of the Act requires amounts deposited in the "Municipal Development Fund" of municipalities not covered by the Act to be redistributed to the municipalities covered by the Act,
- .2% will be deposited in a "Municipal Redemption Fund" to guarantee and repay long-term debt through any financial institution (each semester the municipalities may transfer to their general fund the funds in excess of debt service requirements),
- .1% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE T – SUBSEQUENT EVENTS – Continued

b. Act No. 19 of January 24, 2014

The purpose of this Act is to create the “Municipal Finance Corporation” (“COFIN”), a public corporation and a component unit of the Governmental Development Bank of Puerto Rico (“GDB”), which may issue, pay or refinance long-term debt of municipalities. Principal and interest of these bonds and loans will be guaranteed with the municipal sales and use tax (1%). The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

After July 1, 2014 the 1% corresponding to the municipalities’ sales and use tax will be deposited in COFIN. From these funds COFIN will deposit in the COFIN’s sinking fund the greater of .3% of the 1% municipal sales and use tax or an Annual Rental Fee (“RFA”). The RFA for fiscal year 2014-2015 will be \$65,541,281 and thereafter will be 1.5% of the RFA of the preceding fiscal period. The excess of the required deposit to the COFIN’s sinking fund (.7% of the 1% of the municipal sales and use tax) will be transferred to the general fund of municipalities covered by the agreement or to the Municipal Redemption Fund as decided by the municipality. Before the transfer of the .7% to the municipalities covered by the Act, COFIN will transfer the 1% municipal sales and use tax to the municipalities not covered by the Act. These municipalities cannot obtain loans guaranteed by COFIN’s sinking fund.

If at any moment the required deposits to the COFIN’s sinking fund were not sufficient to pay the principal and interest of any outstanding obligation, the deficiency will be covered by appropriations of the Commonwealth’s general fund budget.

As stated above, the purpose of Act 18 and 19 of 2014 is to provide a financial structure to guarantee and pay long-term debt to the municipalities while maintaining adequate cash flows for its operations, as well as to provide liquidity to the GDB.

Notwithstanding the above corrective actions, on February 4, 2014, Standard & Poor’s Rating Services (“S&P”) lowered its rating on the Commonwealth of Puerto Rico’s general obligation (GO) debt to ‘BB+’ from ‘BBB’- and the Commonwealth’s appropriation secured debt and Employee Retirement System (ERS) debt to ‘BB’. In addition, S&P downgraded the GDB to ‘BB’, and the rating remains on CreditWatch with negative implications. S&P has not taken a rating action on sales tax-secured debt of COFINA, but has retained their negative outlook on their COFINA ratings reflecting S&P’s view of the economic outlook and that COFINA sales tax is not subject to the prior diversion of revenue for general obligation debt service payments. The downgrades follow S&P’s evaluation of liquidity for the Commonwealth, including what they believe is a reduced capacity to access liquidity from GDB. S&P also believes that the Commonwealth’s access to liquidity and to the market either through GDB or other means will remain constrained in the medium term. The S&P rating is not lower due to the progress the current administration has made in reducing operating deficits and the recent success with reform of the public employee and teacher pension systems. They view those reforms as significant which could contribute to a sustainable path to fiscal stability.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE T – SUBSEQUENT EVENTS – Continued

In addition, on February 7, 2014, Moody's Investors Service ("Moody's") has downgraded the general obligation (GO) rating of the Commonwealth of Puerto Rico, the Pension funding bonds and GDB senior notes to 'Ba2' from 'Baa3'. Other ratings that are capped by or linked to the Commonwealth's GO rating were also downgraded two notches, with the exception of the Puerto Rico Aqueduct and Sewer Authority (PRASA) Revenue Bonds, which were downgraded to 'Ba2' from 'Ba1'. At the same time, Moody's downgraded the Puerto Rico Sales Tax Financing Corporation's (COFINA's) senior-lien bonds to 'Baa1' from 'A2' and its junior-lien bonds to 'Baa2' from 'A3'. The outlooks for ratings on the GO and the related bonds, as well as the COFINA bonds, are negative. The downgrade is a result of, among others, Commonwealth's problems in years of deficit financing, pension underfunding, budgetary imbalance and seven years of economic recession. As a result, Commonwealth's debt load and fixed costs are high, its liquidity is narrow, and its market access has become constrained. Moody's recognizes major actions taken to stabilize Commonwealth finances, including the significant reform to the main pension system, and tax increases to reduce budget deficit.

Furthermore, on February 11, 2014 Fitch Ratings (Fitch) has downgraded the ratings, among other instrumentalities, for the Commonwealth general obligation (GO) bonds and ERS pension funding bonds from 'BB' from 'BBB'. The current action does not affect the ratings that Fitch assigns to bonds issued by COFINA, since those bonds are secured by the Commonwealth's sales and use tax and insulated from the Commonwealth's general credit strain. Fitch reported that recent downgrades have triggered new liquidity requirements and lowered expectations for the market available for the Commonwealth's debt going forward, though there have been no significant negative developments regarding the Commonwealth's finances or economy since November 2013. In addition, the report recognizes that the Commonwealth's management has responded quickly and decisively to challenges that have arisen in recent years and the current administration has made significant progress in addressing long standing credit issues.

These downgrades may have a significant impact in the economic environment of Puerto Rico and the Commonwealth Government, its instrumentalities and the municipalities in critical areas such as access to markets and liquidity for the current fiscal year and thereafter. It is the opinion of the Commonwealth and the Municipality of Hormigueros management that the corrective actions taken and to be taken in current and fiscal periods thereafter will lower the impact of this decision and cause a positive turnaround on the Commonwealth's and the Municipality's finances.

REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2013

	Budgeted amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis) (See Note A)	Final Budget Positive (Negative)
Revenues:				
Taxes:				
Property taxes	\$ 2,678,659	\$ 2,678,659	\$ 2,681,901	\$ 3,242
Municipal license taxes	1,420,000	1,420,000	1,465,508	45,508
Sales and use taxes	1,446,000	1,446,000	1,612,132	166,132
Intergovernmental	2,913,730	2,913,730	2,921,342	7,612
Fees, fines and charges for services	2,135,858	2,135,858	2,206,984	71,126
Interest	50,000	50,000	53,698	3,698
Other	72,500	92,500	174,335	81,835
Total revenues	<u>10,716,747</u>	<u>10,736,747</u>	<u>11,115,900</u>	<u>379,153</u>
Expenditures:				
Current:				
General government	5,489,628	5,892,703	5,770,512	122,191
Public works and sanitation	2,200,940	2,060,133	2,053,311	6,822
Public safety	884,881	868,028	862,880	5,148
Culture and recreation	846,579	822,426	833,099	(10,673)
Health	379,719	363,719	361,299	2,420
Welfare and community development	628,488	632,716	628,848	3,868
Education	21,800	21,900	21,900	-
Total expenditures	<u>10,452,035</u>	<u>10,661,625</u>	<u>10,531,849</u>	<u>129,776</u>
Excess of revenues over expenditures	264,712	75,122	584,051	508,929
Other financing sources (uses):				
Transfers in	-	64,590	64,590	-
Transfers out	(264,712)	(264,712)	(261,236)	3,476
Total other financing sources (uses)	<u>(264,712)</u>	<u>(200,122)</u>	<u>(196,646)</u>	<u>3,476</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	-	(125,000)	387,405	512,405
Readjustment from prior year fund balance (note B)	-	125,000	125,000	-
Excess of revenues and other financing sources over expenditures and other financing uses after readjustment from prior year fund balance	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 512,405</u>	<u>\$ 512,405</u>

The accompanying notes to required supplemental information are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
JUNE 30, 2013

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1991, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared.

Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The Budget Comparison Schedule - General Fund provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis encumbrances outstanding at year-end are reported in the governmental funds statements as assigned fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of the current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year-end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET READJUSTMENT

The Budgetary Comparison Schedule - General Fund presents a fund balance readjustment of \$125,000. This represents a readjustment of current year budget with prior year's budgetary surpluses.

NOTE C - BUDGET TO GAAP RECONCILIATION

The accompanying Budgetary Comparison Schedule – General Fund presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
June 30, 2013

NOTE C - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ 512,405
Budget to GAAP differences:	
Entity differences:	
Non-budgeted funds recorded as revenues for financial reporting purposes	159,787
Non-budgeted funds recorded as expenditures for financial reporting	(1,372,459)
Non-budgeted transfers in	1,297,013
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis	174,137
Revenues recorded in budgetary basis but not for financial reporting purposes	(174,516)
Readjustment from prior year fund balance recorded for budgetary basis purposes but not in financial reporting	(125,000)
Expenditures recorded for financial reporting purposes but not in budgetary basis	(176,777)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes	24,401
Prior year encumbrances recorded as expenditures for financial reporting purposes	(23,802)
Net change in fund balance (GAAP basis)	<u>\$ 230,598</u>

SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14,871
		Housing Choice Vouchers
Balance Sheet		
111	Cash - unrestricted	\$ 25,661
113	Cash - other restricted	\$ 10,633
100	Total cash	\$ 36,294
121	Accounts receivable - PHA projects	\$ 19,490
122	Accounts receivable - HUD other projects	\$ 6,940
125	Accounts receivable - miscellaneous	\$ -
126.2	Allowance for doubtful accounts - other	\$ -
128	Fraud recovery	\$ 311
128.1	Allowance for doubtful accounts - fraud	\$ -
120	Total receivables, net of allowance for doubtful accounts	\$ 26,741
142	Prepaid Expenses and Other Assets	\$ 42
144	Inter program - due from	\$ -
150	Total Current Assets	\$ 63,077
164	Furniture, equipment and machinery - administration	\$ 24,317
166	Accumulated depreciation	\$ (19,909)
160	Total capital assets, net of accumulated depreciation	\$ 4,408
180	Total Non-current Assets	\$ 4,408
190	Total Assets	\$ 67,485
312	Accounts payable <= 90 days	\$ 10,383
322	Accrued compensated absences - current portion	\$ 7,751
331 - 030	Accounts payable - HUD PHA programs - Other	\$ -
332	Accounts Payable - PHA Projects	\$ 13,232
333	Accounts payable - other government	\$ 9,987
341	Tenant security deposits	\$ -
342	Deferred revenue	\$ -
345	Other current liabilities	\$ 1,479
347	Inter-program - due to	\$ -
348	Loan Liability - current	\$ -
310	Total Current Liabilities	\$ 42,832
353	Non-current liabilities - other	\$ 3,080
354	Accrued compensated absences - non current	\$ 7,704
350	Total Non-current Liabilities	\$ 10,784
300	Total Liabilities	\$ 53,616
508.1	Invested in Capital Assets, Net of Related Debt	\$ 4,408
511.1	Restricted Net Assets	\$ -
512.1	Unrestricted Net Assets	\$ 9,461
513	Total Equity/Net Assets	\$ 13,869
600	Total Liabilities and Equity/Net Assets	\$ 67,485

(Continues)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14.871	
			Housing Choice Vouchers
Income Statement			
70600-010	Housing assistance payments	\$	525,407
70600-020	Ongoing administrative fees earned	\$	64,542
70600-070	Admin fee calculation description		
70600	HUD PHA operating grants	\$	589,949
71100-010	Housing Assistance Payment	\$	-
71100-020	Administrative Fee	\$	-
71100	Investment income - unrestricted	\$	21
71400-010	Housing Assistance Payment	\$	-
71400-020	Administrative Fee	\$	-
71400	Fraud recovery	\$	-
71500	Other revenue	\$	52,465
71600	Gain or loss on the sale of capital assets	\$	-
72000-010	Housing Assistance Payment	\$	-
72000-020	Administrative Fee	\$	-
72000	Investment income - restricted	\$	9
700	Total Revenue	\$	642,444
91100	Administrative salaries	\$	50,062
91200	Auditing fees	\$	5,000
91500	Employee benefit contributions- administrative	\$	18,210
91600	Office expenses	\$	8,547
91800	Travel	\$	196
91000	Total Operating - Administrative	\$	82,015
96200	Other general expenses	\$	2,282
96210	Compensated absences	\$	-
96600	Bad debt - other	\$	-
96000	Total Other General Expenses	\$	2,282
96900	Total Operating Expenses	\$	84,297
97000	Excess Revenue Over Operating Expenses	\$	558,147
97300-020	Home-Ownership	\$	4,086
97300-050	All Other	\$	533,508
97300	Housing assistance payments	\$	537,594
97350	HAP Portability-In	\$	33,784
97400	Depreciation expense	\$	102
97500	Fraud losses	\$	-
900	Total Expenses	\$	655,777
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$	(13,333)
11030	Beginning equity	\$	27,202
11770-001	Administrative Fee Equity - Beginning Balance	\$	15,024
11170-010	Administrative Fee Revenue	\$	64,542
11170-020	Hard to House Fee Revenue	\$	-
11170-021	FSS Coordinator Grant	\$	-
11170-030	Audit Costs	\$	-
11170-040	Investment Income	\$	21
11170-045	Fraud Recovery Revenue	\$	-
11170-050	Other Revenue	\$	52,465
11170-051	Comment For Other Revenue		
11170-060	Total Admin Fee Revenues	\$	117,028
11170-080	Total Operating Expenses	\$	84,297
11170-090	Depreciation	\$	102
11170-095	Housing Assistance Portability In	\$	33,784
11170-100	Other Expenses	\$	-
11170-101	Comment For Other Expense		
11170-110	Total Expenses	\$	118,183
11170-002	Net Administrative Fee	\$	(1,155)
11170-003	Administrative Fee Equity - Ending Balance	\$	13,869
11170	Administrative Fee Equity	\$	13,869
11180-001	Housing Assistance Payments Equity - Beginning Balance	\$	12,178
11180-010	Housing Assistance Payments Revenues	\$	525,407
11180-015	Fraud Recovery Revenue	\$	-
11180-020	Other Revenue	\$	-
11180-021	Comment For Other Revenue		
11180-025	Investment Income	\$	9
11180-030	Total HAP Revenues	\$	525,416
11180-080	Housing Assistance Payments	\$	537,594
11180-100	Total Housing Assistance Payments Expenses	\$	537,594
11180-002	Net Housing Assistance Payments	\$	(12,178)
11180-003	Housing Assistance Payments Equity - Ending Balance	\$	-
11180	Housing Assistance Payments Equity	\$	-
11190-210	Total ACC HCV Units		1,236
11190	Unit Months Available		1,236
11210	Unit Months Leased		1,203

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
June 30, 2013

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (FDS) is a trial balance of the Section 8 Housing Choice Voucher Program administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (PHA) to the Real Estate Assessment Center (REAC), as required by the Uniform Financial Reporting Standards (UFRS). REAC is the US Department of Housing and Urban Development (HUD) national management center created to assess the condition of HUD owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements. It is prepared using the accrual basis of accounting, as required by REAC regulations.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

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

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
<u>U.S. Department of Agriculture</u>			
Passed-through program from:			
<u>P.R. Department of Education</u>			
Child and Adult Care Food Program	10.558	CCC-029	<u>\$ 17,411</u>
<u>U.S. Department of Housing and Urban Development</u>			
Direct programs:			
Shelter Plus Care	14.238	N/A	41,412
Section 8 Housing Choice Vouchers Program	14.871	N/A	589,949
Passed-through programs from:			
<u>Office of Commissioner of Municipal Affairs:</u>			
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	14.228	FC-30, AB-30 ADM-30	992,392
<u>P.R. Department of Health:</u>			
Housing Opportunities for Persons with AIDS (HOPWA)	14.241	2013-V01187	65,594
<u>P.R. Department of Family:</u>			
Emergency Solutions Grant Program	14.231	S09DC72001	85,764
<u>P.R. Department of Housing - (Puerto Rico Public Housing Administration "PRPHA"):</u>			
Public and Indian Housing	14.850	RQ-00500106D	<u>159,319</u>
Subtotal U.S. Department of Housing and Urban Development			<u><u>1,934,430</u></u>
<u>U.S. Department of Transportation</u>			
Direct program:			
Federal Transit Formula Grants	20.507	N/A	<u>68,375</u>
<u>U.S. Department of Energy</u>			
Passed-through program from:			
<u>P.R. Energy Affairs Administration:</u>			
ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	FOA-00013-13	<u>76,546</u>
<u>U.S. Department of Health and Human Services</u>			
Passed-through programs from:			
<u>P.R. Office of Ombudsman Administration (OAP):</u>			
Special Programs for the Aging Title III Part D Disease Prevention and Health Promotion Services	93.043	130142R2, 130267R2, 130411R2	3,447
National Family Caregiver Support, Title III, Part E	93.052	130199R2	34,230
Nutrition Services Incentive Program	93.053	130411R2, 130142R2	30,152
<u>P.R. Department of Family - Families and Children Administration:</u>			
Child Care and Development Block Grant	93.575	2012-2013-241-2013-000071-B, 2012-2013-241-2013-000071-C	<u>110,584</u>
Subtotal U.S. Department of Health and Human Services:			<u>178,413</u>
Total Expenditures of Federal Awards			<u><u>\$ 2,275,175</u></u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2013**

NOTE A – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality under programs of the federal government for the year ended June 30, 2013. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements. Because the Schedule presents only a selected portion of the operations of the Municipality, it is not intended to and does not present the financial position and changes in net assets of the Municipality.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

State or local government redistributions of federal awards to the Municipality, known as "pass-through awards", should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the Schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for the federal awards received as a sub recipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

NOTE C – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

Description	Community Development Block Grant Program Fund	Other Governmental Funds
10.558	\$ -	\$ 17,411
14.238	-	41,412
14.228	992,392	-
14.871	-	589,949
14.241	-	65,594
14.231	-	85,764
14.850	-	159,319
20.507	-	68,375
ARRA – 81.128	-	76,546
93.043	-	3,447
93.052	-	34,230
93.053	-	30,152
93.575	-	110,584

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2013

NOTE C – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS - Continued

<u>Description</u>	<u>Community Development Block Grant Program Fund</u>	<u>Other Governmental Funds</u>
Total federal awards expenditures	\$ 992,392	\$ 1,282,783
Additional amount recorded as expenditures under modified accrual basis for Low Rent and Section 8 HCV Programs	-	(63,355)
Non-federal awards expenditures	-	498,767
Total expenditures, fund statements	<u>\$ 992,392</u>	<u>\$ 1,718,195</u>

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

P.O. Box 364831
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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Honorable Mayor
and Members of the Municipal Legislature
Municipality of Hormigueros
Hormigueros, 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 Municipality of Hormigueros (the Municipality) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements, and have issued our report thereon dated March 28, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 the Municipality's internal control. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses, or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

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 entity's internal control or on compliance. This report is an integral part of an audit performed 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.

Valdés, Sandra, María E. Martínez, LLP

San Juan, Puerto Rico
March 28, 2014

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to the original

VALDES, GARCIA, MARIN & MARTINEZ, LLP

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

To the Honorable Mayor
And Members of the Municipal Legislature
Municipality of Hormigueros
Hormigueros, Puerto Rico

Report on Compliance for Each Major Federal Program

We have audited the Municipality of Hormigueros' (the Municipality) compliance with the types of compliance requirements described in *OMB Circular A-133 Compliance Supplement* that could have direct and material effect on each of the Municipality's major federal programs for the year ended June 30, 2013. The Municipality's major federal programs are identified in the Summary of Audit Results 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.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the 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 non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Municipality'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 the Municipality's compliance.

Basis for Qualified Opinion on CFDA 14.871 Section 8 Housing Choice Vouchers Program

As described in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with requirements regarding CFDA 14.871 Section 8 Housing Choice Vouchers Programs described in findings numbers 2013-III-2 for Reporting, 2013-III-3 for Special Test and Provisions-Reasonable Rent and 2013-III-6 for Special Test and Provisions-HQS Enforcement. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

Qualified Opinion on Section 8 Housing Choice Vouchers Program

In our opinion, except for the non-compliance described in the Basis for Qualified Opinion paragraph, the Municipality complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on Section 8 Housing Choice Vouchers Program for the year ended June 30, 2013.

Unmodified Opinion on Each of the Other Major Federal Program

In our opinion, the Municipality complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect of its other major federal programs identified in the Summary of Audit Results section of the accompanying Schedule of Findings and Questioned Costs for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed other instances of non-compliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2013-III-1, 2013-III-4, 2013-III-5, 2013-III-7, and 2013-III-8. Our opinion on each major federal program is not modified with respect to these matters.

The Municipality's response to the non-compliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The 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 the 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 the 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 the Municipality's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be 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 and significant deficiencies.

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, non-compliance 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 non-compliance 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-III-2, 2013-III-3 and 2013-III-6 to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2013-III-1, 2013-III-4, 2013-III-5, 2013-III-7, and 2013-III-8 to be significant deficiencies.

The Municipality's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The 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.

San Juan, Puerto Rico
March 28, 2014

Valdés, Diana, María E. Martínez, CPA

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Audit Results

FISCAL YEAR ENDED JUNE 30, 2013

A. Summary of audit results:

Part I - Financial Statements

1. Type of audit report: issued Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion

Internal control over Financial Reporting

2. Significant deficiencies identified? Yes No
3. Significant deficiencies reported as material weaknesses? Yes None reported
4. Material noncompliance disclosed? Yes No

Part II - Federal Awards

Internal control over Major Programs

1. Significant deficiencies identified? Yes No
2. Significant deficiencies reported as material weaknesses? Yes None reported
3. Type of auditors' report on compliance major programs Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Audit findings required to be reported under Section 510(a) of Circular A-133 Yes No

5. Identification of major programs

CFDA Number(s)	Name of Federal Program or Cluster
14.228	Community Development Block Grants/State's Program and Non-Entitlement Grant in Hawaii
14.850	Public and Indian Housing
14.871	Section 8 Housing Choice Vouchers

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FISCAL YEAR ENDED JUNE 30, 2013

Section II - Financial Statements Findings

Finding	No matters reported.
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-1

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Number: 14.871

Regulation Requirement: Eligibility for Individuals

Type: Internal Control and Compliance

Condition

We performed an eligibility test for twenty four participant files and noted the following exceptions:

1. In two files we did not find the evidence of income related to the annual re-examination (many of the family members of 18 years old or more).
2. In one case we did not find evidence of Department of Labor Certification for all members of 18 years old or more.
3. In two cases we did not find evidence of the Family Child Support (ASUME) Certification or the Father Child Support Certification.
4. In two cases we noted that although the Form-50058 indicated an amount of income, we did not find evidence of it in the files.
5. In six cases we noted several documents dated after the effective date indicated in the annual re-examination (Form-50058) and the effective date of the contract.
6. In one case the Authorization for Release of Information/Privacy Act Notice did not have the signature of all family members of 18 years old or more.
7. In two cases the Authorization for Release of Information/Privacy Act Notice did not include the signature date for all family members of 18 years old or more.
8. In one case the Authorization for Release of Information/Privacy Act Notice was missing in the file.
9. In two cases the evidence of US Citizenship Declaration Form for all family members was missing in the file.
10. In one case the Value of Assets Verification for all family members of 18 years old or more was missing in the file.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-1 (CONTINUED)

11. In five cases the Good Behavior Certification for all family members of 18 years old or more was missing in the file.
12. In four cases the married or divorce certification was missing in the file.
13. In four cases the Certification of Movable and Immovable Property (CRIM) was not in the file.
14. In one case the HAP Contract or Amendment applicable to the fiscal year under audit was not available for our examination.
15. In fifteen cases the HAP contract did not indicate the signature date.
16. In two cases the HAP Contract did not have the Public Housing Agency representative's signature.

Criteria

24 CFR Subpart K Section 982.516, *PHA responsibility for reexamination and verification* (a) establishes that PHA responsibility for reexamination of family income and composition at least annually, (2) The PHA must obtain and document in the tenant file third-party verification of the following factors, or must document in the tenant file why third party verification was not available: (i) Reported family annual income; (ii) The Value of Assets, (iii) Expenses related to deduction from annual income; and (iv) Other factors that affect the determination of adjusted income.

24 CFR Subpart F, Section 5.611, *Adjusted Income*, establishes adjusted income and deduction permitted in federal regulations. 24 CFR Subpart E, Section 982.201, *Eligibility and Targeting*, establishes when an applicant is eligible: *General*, the PHA may only admit an eligible family to the program. To be eligible, the applicant must be "family"; must be income-eligible in accordance with paragraph (b) of this section and 24 CFR part 5, subpart F; must be a citizen or a no citizen who has eligible immigration status as determined in accordance with 24 CFR part 5, subpart E. 24 CFR Subpart B, Section 5.230, *Consent by assistance applicants and participants*.

The Housing Choice Voucher Program Guidebook, Chapter 12 Section (12.4), *Reexamination Procedures* establishes procedures for the reexamination process. Also, the Housing Authority Administrative Plan for Fiscal Year 2007 establishes procedures for the following: Section 3.2, *Eligibility Criteria*, Section 6.4, *Term of the Housing Choice Voucher*, Section 9.0, *Determination of Family Income*, Section 10.0, *Verification*, Section 11.0, *Rent and Housing Payment*, Section 14.0, *Recertification*, Section 17.0, and *Termination of the Lease and Contract*.

Effect

The Municipality may be qualifying participants that do not meet the eligibility requirements established by federal regulations and this should have an effect in the performance on the SEMAP report.

Cause

Programs personnel did not maintain organized files and did not obtain required documentation to validate the participant's eligibility. In addition, the Municipality has no effective monitoring review process for the program internal quality control.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-1 (CONTINUED)

Recommendation

The Municipality should establish internal control procedures for proper supervision over the eligibility qualification process to ensure compliance with the requirements established in the federal regulations and to obtain all the documentation required to maintain in the files evidence of Program participants eligibility.

Questioned Cost

Could not be determined

Management Response

Refer to Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-2

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Numbers: 14.871

Regulation Requirement: Reporting

Type: Internal Control and Compliance

Condition

We examined twenty four participants' files and the Family Report (HUD form 50058) and noted the following exceptions:

1. In one case the family component in HUD's Form 50058 was incorrect.
2. In one case the annual income reported in HUD's Form 50058 was calculated incorrectly.
3. In one case the utility allowance reported in HUD's Form 50058 was incorrect; therefore, the utility reimbursement to tenant was incorrect.
4. In one case the Total Tenant Payment (TTP) reported in HUD's Form 50058 was incorrect; therefore, the utility reimbursement to tenant was incorrect.
5. In nine cases the information included in item 5i "Date of Last Annual HQS Inspection" and item 5h "Date of Unit Last Passed HQS Inspection" in HUD's Form 50058 was incorrect.
6. In six cases we noted that the Payment Standard reported in HUD's Form 50058 was incorrect, therefore, the utility allowance to tenant was also incorrect.
7. In one case the amount of rent to owner reported in HUD's Form 50058 did not agree with the HAP contract.

Criteria

24 CFR Subpart D Section 982.158, *Program accounts and records* establishes in item (a) that the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. The records must be in the form required by HUD, including requirements governing computerized or electronic forms of record-keeping. The PHA must comply with the financial reporting requirements in CFR part 5, Subpart H. 24 CFR Subpart D Section 982.158 (b), establishes that the PHA must furnish to HUD accounts and other record, reports, documents, and information, as required by HUD. For provisions on electronic transmission of required family data, see 24 CFR parts 908. 24 CFR Subpart D Section 982.158 (d), establish that the PHA must prepare a unit inspection report.

24 CFR Subpart K Section 982.516 (f), *Accuracy of family income data*, establishes that the PHA must establish procedures that are appropriate and necessary to assure that income data provided by applicant or participant families is complete and accurate.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-2 (CONTINUED)

Effect

The Municipality could be exposed to non-compliance with federal regulations as per result of the data processed in HUD Form-50058,-Family Report and could have an effect in the performance on SEMAP report. In addition, errors in HUD Form-50058 income may result in incorrect adjusted annual income, total payment and tenant rent that could lead incorrect HAP payment.

Cause

The condition is the result of ineffective review procedures necessary to assure completeness of special report. The Program has no effective monitoring review procedures for the income evidence and income calculation.

Recommendation

The Municipality should strengthen review procedures of the information recorded in HUD's Form-50058, Family Report.

Questioned Cost

Could not be determined

Management Response

Refer to Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-3

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Numbers: 14.871

Regulation Requirement: Special Test and Provisions – Reasonable Rent

Type: Internal Control and Compliance

Condition

We performed a compliance test for twenty four participants' files and noted that in six cases the Payment Standard amount included in the HUD's Form 50058 was incorrect according to the number of bedrooms on voucher and the Fair Market Value Table for the fiscal year 2012-2013.

Criteria

24 CFR Subpart B Section 982.54, *Administrative Plan*, item (d) (15), establishes that the PHA Administrative Plan must cover PHA policies on several subjects including the method of determining that the rent to owner is a reasonable rent (initially and during the term of a HPA contract).

24 CFR, Subpart K, Section 982.503 (a), *Payment standard schedule*, establishes that (1) HUD publishes the fair market rents for each market area in the United States (see part 888 of this title). The PHA must adopt a payment standard schedule that establishes voucher payment standard amounts for each FMR area in the PHA jurisdiction. For each FMR area, the PHA must establish payment standard amounts for each "unit size." Unit size is measured by number of bedrooms (zero-bedroom, one-bedroom, and so on). (2) The payment standard amounts on the PHA schedule are used to calculate the monthly housing assistance payment for a family (§ 982.505). (3) The PHA voucher payment standard schedule shall establish a single payment standard amount for each unit size. For each unit size, the PHA may establish a single payment standard amount for the whole FMR area, or may establish a separate payment standard amount for each designated part of the FMR area.

24 CFR Subpart K Section 982.507, *Rent to owner: reasonable rent*, in item (4) establishes that at all times during the assisted tenancy, the rent to owner may not exceed the reasonable rent as most recently determined or predetermined by the PHA.

Effect

The miscalculation of rent payments can have an effect in the following: (1) total family share, (2) HAP to owner, (3) tenant rent to owner and, (4) utilities reimbursement to family (if apply) and could have an effect in the performance on SEMAP report.

Cause

The Municipality has no effective monitoring review process over the Payment Standard calculation procedures and the Administrative Plan requirements for the payment standard calculation to adequately determine the Reasonable Rent during the reexamination process.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-3 (CONTINUED)

Recommendation

The Municipality should establish adequate review procedures to ascertain that the Payment Standard amount applicable in the reexamination is computed correctly and in accordance with federal regulations.

Questioned Cost

Could not be determined

Management Response

Refer to Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-4

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Numbers: 14.871

Regulation Requirement: Special Test and Provisions – Utility Allowance Schedule

Type: Internal Control and Compliance

Condition

We performed a utility allowance test for twenty four participants and noted the following exceptions:

1. In one case the utility allowance was calculated incorrectly in the Family Report (HUD Form – 50058). Although the HAP contract indicates that the utilities of water and electricity did not apply to the tenant because their costs are included in the monthly rent rate they were considered in the tenant utility allowance.
2. In ten cases the evidence for the utility charges (water and/or electricity invoices) was missing in files but the charges were considered in the calculation of the utility allowance.

Criteria

24 CFR, Subpart K, Section 982.517 (a), *Maintaining schedule*, establishes that (1) The PHA must maintain a utility allowance schedule for all tenant-paid utilities (except telephone), for cost of tenant-supplied refrigerators and ranges, and for other tenant-paid housing services (e.g., trash collection (disposal of waste and refuse)).(2) The PHA must give HUD a copy of the utility allowance schedule. At HUD's request, the PHA also must provide any information or procedures used in preparation of the schedule.

24 CFR, Subpart K, Section 982.517 (b), *How allowances are determined*, (1) The utility allowance schedule must be determined based on the typical cost of utilities and services paid by energy-conservative households that occupy housing of similar size and type in the same locality. In developing the schedule, the PHA must use normal patterns of consumption for the community as a whole and current utility rate. (2)(i) a PHA's utility allowance schedule, and the utility allowance for an individual family, must include the utilities and services that are necessary in the locality to provide housing that complies with the housing quality standards.

Effect

The Municipality could be paying an incorrect amount of the utility allowance to the participants and this could have an effect in the performance on SEMAP report.

Cause

The Program has no effective monitoring review process over the utility allowance calculation procedures and for the determination of the correct amount of the utility allowance that will be paid to the tenants. In addition, there is a lack of effective review process of the participant's file to ensure that the Municipality obtains all the support for the utilities allowance.

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Reference Number: 2013-III-4 (CONTINUED)

Recommendation

The Municipality should establish review procedures to ascertain that tenant's utility allowance is calculated correctly and in accordance with federal regulations.

Questioned Cost

Could not be determined

Management Response

See Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-5

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Numbers: 14.871

Regulation Requirement: Special Test and Provisions – Housing Quality Standard Inspection

Type: Internal Control and Compliance

Condition

We performed audit procedures for twenty four Housing Quality Standard Inspection reports and noted the following:

1. In three cases we did not find evidence that the Municipality performed the unit inspection for the fiscal year 2012-2013.
2. In two cases the inspection report did not indicate the inspection date, therefore, we could not determine if the inspection was performed during the fiscal year under audit.
3. In two cases we noted that the inspection report had incomplete information.
4. In four cases the name of inspector who performed the unit inspection and his signature was not indicated in the inspection report.

Criteria

24 CFR Subpart I, Section 982.405, (a) establishes that the PHA must inspect the unit leased to a family prior to the initial term of the lease, at least annually during assisted occupancy, and at other times as needed, to determine if the unit meets the HQS. (See Sec. 982.305(b) (2) concerning timing of initial inspection by the PHA.) (b) The PHA must conduct supervisory quality control HQS inspections. (c) In scheduling inspections, the PHA must consider complaints and any other information brought to the attention of the PHA. (d) The PHA must notify the owner of defects shown by the inspection. (e) The PHA may not charge the family or owner for initial inspection or re-inspection of the unit.

Effect

The Municipality may be disbursing HAP payments for housing units that do not meet Program requirements.

Cause

Ineffective internal control procedures to ascertain that all tenants' rented units are inspected for HQS at least one annually; in addition, lack of effective internal control over the inspection report information and checklist.

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-5 (CONTINUED)

Recommendation

The Municipality should strengthen procedures to ascertain that all tenant's rented units are inspected for HQS at least one annually and complied with the internal control and federal regulations.

Questioned Cost

Could not be determined

Management Response

Refer to Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF HORMIGUEROS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

Reference Number: 2013-III-6

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Numbers: 14.871

Regulation Requirement: Special Test and Provision – HQS Enforcement

Type: Internal Control and Compliance

Condition

In the testing of the Housing Quality Standards Enforcement procedures for fourteen (14) failed HQS inspection form HUD-52580, we noted the following exceptions:

1. In five cases the inspection report did not indicate the final pass date for each of the deficiencies identified.
2. In four cases the inspected unit was considered by the Inspector Officer without deficiencies (pass), however, in the report it is indicated that the unit had deficiencies that should be repaired within twenty four hours or 30 calendar days from the date of the inspection report.
3. In three cases the inspection report did not indicate the summary decision on unit but the inspection checklist indicated inconclusive areas; however, the unit had deficiencies that had to be repaired within twenty four hours or 30 calendar days from the date of inspection report.
4. In ten cases we did not find evidence that the deficiency of the unit was repaired.
5. In eleven cases the Program did not send to tenant or owner the notification indicating the deficiencies found in the unit and the date of the next re-inspection.

Criteria

24 CFR, Subpart D, Section 982.158 (d) establishes that the PHA must prepare a unit inspection report.

24 CFR Subpart I Section 982.405 (a) establishes that the PHA must inspect the unit leased to a family prior to the initial term of the lease, at least annually during assisted occupancy, and at other times as needed, to determine if the unit meets the HQS. (See Sec. 982.305 (b) (2) concerning timing of initial inspection by the PHA.). (b) The PHA must conduct supervisory quality control HQS inspections. (c) In scheduling inspections, the PHA must consider complaints and any other information brought to the attention of the PHA. (d) The PHA must notify the owner of defects shown by the inspection. (e) The PHA may not charge the family or owner for initial inspection or re-inspection of the unit.

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Reference Number: 2013-III-6 (CONTINUED)

24 CFR Subpart I, Section 982.404 (a), *Owner Obligation*, states that (1) the owner must maintain the unit in accordance with HQS. (2) If the owner fails to maintain the dwelling unit in accordance with HQS, the PHA must take prompt and vigorous action to enforce owner obligations. PHA remedies for such breach of the HQS include termination, suspension or reduction of housing assistance payments and termination of the HAP contract. (3) The PHA must not make any housing assistance payments for a dwelling unit that fails to meet the HQS, unless the owner corrects the defect within the period specified by the PHA and the PHA verifies the correction. If a defect is life threatening, the owner must correct the defect within no more than 24 hours. For other defects, the owner must correct the defect within no more than 30 calendar days (or any PHA approved extension). (4) The owner is not responsible for a breach of the HQS that is not caused by the owner, and for which the family is responsible (as provided in Sec. 982.404 (b) and Sec. 982.551 (c)). (However, the PHA may terminate assistance to a family because of HQS breach caused by the family.)

Effect

The Municipality made housing assistance payments for units that did not meet housing quality standards. This could have an effect in the performance on SEMAP report. Inadequate control over HQS Enforcement and HUD requirement could reduce or recapture Section 8 Voucher funds.

Cause

The Municipality did not implement and maintain adequate internal controls to ensure that housing quality inspection enforcement met HUD requirements.

Recommendation

The Municipality should strengthen its monitoring procedures over deficiencies found in the inspection process. The Municipality should also implement internal controls to follow up actions taken by owners and families to correct deficiencies found and to take prompt action to enforce tenant and family obligations.

Questioned Cost

Could not be determined

Management Response

Refer to Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
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Reference Number: 2013-III-7

Agencies: U.S. Department of Housing and Urban Development

Programs: Section 8 Housing Choice Vouchers

CFDA Numbers: 14.871

Regulation Requirement: Special Test and Provision – Housing Assistance Payment

Type: Internal Control and Compliance

Condition

In a sample of twenty five (25) payments under rental contract, we noted the following exceptions:

1. In one case the Housing Choice Voucher Contract effective as of May 2013 was not provided for our examination.
2. In two cases the Housing Assistance Payment did not agree with the HAP Contract.

Criteria

24 CFR Subpart D, Section 982.158 establishes that the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. The records must be in the form required by HUD, including requirements governing computerized or electronic forms of record-keeping. The PHA must comply with the financial reporting requirements in 24 CFR parts 5, subpart H. 24 CFR Subpart K, Section 982, establish housing assistance payment procedures.

24 CFR Subpart C, Section 85.20, (a) (2), (b) (3) and (b) (5), 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. *Internal control*, Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes. *Allowable cost*, Applicable OMB cost principles, agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

Effect

Inadequate review procedures over the housing assistance disbursement process may cause that the Municipality incur in cost not allowed, and HUD Department could reduce or recapture Section 8 Voucher funds due to non-compliance.

Cause

The Municipality did not maintain effective internal control over the housing assistance payment process as required by federal regulation. The Program does not maintain a regular monitoring on the monthly rental payments and contracts. In addition, there is no effective supervision over the officer who processes the rental payment report.

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Reference Number: 2013-III-7 (CONTINUED)

Recommendation

The Municipality should improve its internal control over the housing assistance payments in order to comply with the laws and federal regulations.

Questioned Cost

Could not be determined

Management Response

Refer to Grantee's Corrective Action Plan

**COMMONWEALTH OF PUERTO RICO
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Reference Number: 2013-III-8

Agencies: U.S. Department of Housing and Urban Development

Programs: Public and Indian Housing (Puerto Rico Public Housing Administration)

CFDA Numbers: 14.850

Regulation Requirement: Special Test and Provisions – Systems Inspections

Type: Internal Control and Compliance

Condition

We performed audit procedures for seven inspection reports and noted the following exceptions:

1. In six cases we noted that the inspection report did not indicate the final pass date for each deficiency identified during the inspection.
2. In three cases the inspection was not performed on time (at least one in the year).

Criteria

Public Housing Management Agent Services Agreement, Clause 11 *Site, Building and Unit Inspections*, establishes that the Municipality agrees to conduct and record, on an acceptable form approved by the PRPHA, the site, buildings and unit inspections utilizing criteria applicable to state and the Uniform Physical Condition Standards (UPCS) or any successor standards, as may be required by HUD or the PRPHA. The inspection criteria to be utilized when conducting all forms of unit inspections will include, but not be limited to, move-in, move out, housekeeping, complaint, preventive maintenance, annual, semi-annual or any other type of inspection. All identified emergency deficiencies as a result of the inspections shall either be corrected or mitigated during the inspection process or deferred to a work order for correction or mitigation within 24 hours. All identified non-emergency deficiencies as a result of the inspection shall either be repaired during the inspection process or deferred to a work order for repair within 20 calendar days of the inspection date. The Municipality agrees to maintain adequate tracking systems for unit and systems inspections and supporting documentation review by PRPHA and/or HUD and shall provide certification to the information at the end of PRPHA's fiscal year.

Notwithstanding the foregoing, every unit must be annually certified to the effect that it meets the UPCS standards, or any successor standards prescribed by HUD or the PRPHA. On or before the 15th day of January of each year the Municipality shall furnish the PRPHA a certification that all required UPCS inspection took place on or before the 31st of December of the preceding year.

Public Housing Management Agent Services Agreement, Clause 12 *System Inspections*. The Municipality agrees to conduct and record a major systems inspections that utilizes manufacturer's specifications, local codes or ordinances and HUD and PRPHA standards for all systems located on each Project. Identified major systems shall include, but are not limited to, the systems identified in 24 CFR Part 901 and 902. All identified emergency deficiencies as a result of the inspections shall either be corrected or mitigated within 24 hours. All identified non-emergency deficiencies as a result of the inspection shall either be repaired during the inspection process or deferred to a work order for repair within 20 calendar days of the inspection date. The Municipality shall be required to report these work orders to PRPHA prior to them becoming outstanding (over 20 days).

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Reference Number: 2013-III-8 (CONTINUED)

Effect

The Municipality made housing assistance payment for units that did not meet housing quality standards.

Cause

The Municipality did not implement and maintain adequate internal controls to ensure that housing inspections were made according to HUD requirements. In addition, the Municipality did not have the funds needed to repair the deficiency found in the inspection report.

Recommendation

The Municipality needs to implement effective internal controls to ensure that units are inspected in a timely manner and inspections are accordance with its administrative plan and HUD requirement.

Questioned Cost

None

Management Response

Refer to Grantee's Corrective Action Plan

