



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO**

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

**AS OF AND FOR THE  
FISCAL YEAR ENDED JUNE 30, 2011**



COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY  
REQUIRED SUPPLEMENTARY INFORMATION  
FISCAL YEAR ENDED JUNE 30, 2011

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## INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Members of the  
Municipal Assembly  
Municipality of Humacao, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Humacao, Puerto Rico**, as of and for the year ended June 30, 2011, which collectively comprise the Municipality of Humacao, Puerto Rico's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of Humacao, Puerto Rico's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

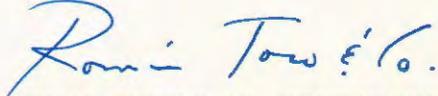
In our opinion, the financial statements referred to above present fairly, in all material respects, financial position of the governmental activities and each major fund and the aggregate remaining fund information of the Municipality of Humacao, Puerto Rico, as of June 30, 2011, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we also issued our report dated March 26, 2012, on our consideration of the Municipality of Humacao, Puerto Rico's internal control over financial reporting and 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 result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

**INDEPENDENT AUDITOR'S REPORT  
(CONTINUED)**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 16 and 54 through 55 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

  
ROMAN TORO & CO., CONTADORES  
PUBLICOS AUTORIZADOS, CSP  
LICENSE #35 - IN FORCE

Yauco, Puerto Rico  
March 26, 2012

Stamp #E18594 was affixed to  
the original of this report



**MANAGEMENT DISCUSSION AND ANALYSIS**

The following discussion and analysis of the Municipality of Humacao's financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2011. Please read it in conjunction with the financial statements which follow this section.

## FINANCIAL HIGHLIGHTS

### Highlights for Government-wide Financial Statements

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

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2011 by \$125,027,032 and 2010 by \$123,039,048, as restated (net assets).
- Revenues decreased by \$566,921 (.43%) and expenses decreased \$313,347 (0.25%) in comparison with year 2010.
- Net change in net assets amounted to \$1,987,984, a decrease of 6% with respect to prior year (2010) net change.

### Highlights for Fund Financial Statements

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

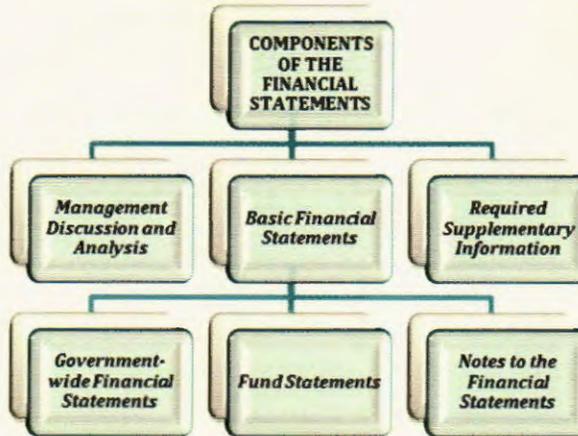
- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$51,910,799, a decrease of \$10,825,447 in comparison with the prior year.
- The General Fund reported an excess of revenues over expenditures of \$4,196,577 and Net Transfer In/Out to Other Funds for the year was \$251,308. Transfers to Debt Service Fund to cover the principal and interests of operating bonds were made for the amount of \$351,385. General Fund reported unassigned fund balance of \$12,468,311, an increase of \$4,155,126 from prior year, as restated.

### General Financial Highlights

- The investment in net capital assets as of June 30, 2011 was \$87,977,155 (net of related debt).
- Long-Term General and Special Obligations increased to \$71,046,785 a decrease of \$1,101,504 in comparison with prior year balance, due to the payments of principal made during the year.
- Other long-term debts increases and net reductions from payments amounted to \$505,039 and \$1,568,661, respectively.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$4,556,810.
- Revenues increased (\$2,996,374) were mainly due to \$2,262,289 of volume of business taxes. Expenditures were less than estimated by \$1,560,436.

## OVERVIEW OF THE FINANCIAL STATEMENTS

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



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

### Basic Financial Statements

- **Government-Wide Financial Statements**

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the *Statement of Net Assets* – presents information on all of the Municipality's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the Municipality's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's roads and other infrastructure may need to be considered to assess the overall health of the Municipality. The second statement – the *Statement of Activities* – presents information showing how the net assets 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 reports as governmental activities the Municipality's basic services such as public safety, public works, health and sanitation, culture and recreation, solid waste disposal, human services and welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

- **Fund Financial Statements**

Governmental funds 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 financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Municipality's near-term financing requirements.

The Municipality implemented **GASB Statement 54, Fund Balance Reporting and Governmental Fund Type Definitions** effective with the June 30, 2011 financial statements. Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent. The June 30, 2010 fund balances were reclassified for comparative purposes.

In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. At the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$51,910,799. Approximately 24% of this amount is available for spending at the government's discretion (Unassigned Fund Balance). The remainder of fund balance is restricted, committed or assigned to indicate that is not available for new spending because it has already been committed.

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

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

- **Notes to the Financial Statements**

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

### **Required Supplementary Information**

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

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

**Net Assets**

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 0.80% with respect to prior year as restated.

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$87,977,155; total capital assets (\$177,035,594) less accumulated depreciation (\$36,600,836) and less any related outstanding debt (\$52,457,603) 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.

The following table presents a summary of the Statements of Net Assets as of June 30, 2011 and 2010:

|  | <b>2011</b>                  | <b>2010</b>                  |
|--|------------------------------|------------------------------|
| Current and Non-current Assets                       | \$ 83,939,793                | \$ 98,669,455                |
| Capital Assets                                       | 140,434,758                  | 126,068,033                  |
| <b>Total Assets</b>                                  | <b><u>224,374,551</u></b>    | <b><u>224,737,488</u></b>    |
| Current Liabilities                                  | 4,946,450                    | 5,740,273                    |
| Deferred Revenues                                    | 16,531,421                   | 15,909,153                   |
| Long-Term Liabilities                                | 77,869,648                   | 80,049,014                   |
| <b>Total Liabilities</b>                             | <b><u>99,347,519</u></b>     | <b><u>101,698,440</u></b>    |
| Net Assets:  |                              |                              |
| Investment in Capital Assets, Net<br>of Related Debt | 87,977,155                   | 86,994,265                   |
| Restricted   | 28,382,288                   | 26,445,262                   |
| Unrestricted   | 8,667,589                    | 9,599,521                    |
| <b>Total Net Assets</b>                              | <b><u>\$ 125,027,032</u></b> | <b><u>\$ 123,039,048</u></b> |

Restricted net assets represent resources that are subject to external restrictions on how they may be used. Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2011 the Municipality presented unrestricted net assets of \$8,667,589. This balance was affected by long-term obligations such as compensated absences \$5,499,169 and other debts for the amount of \$1,323,693 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.

**Changes in Net Assets**

The following table summarizes the changes in net assets for the years ended June 30, 2011 and 2010:

**Table 2**

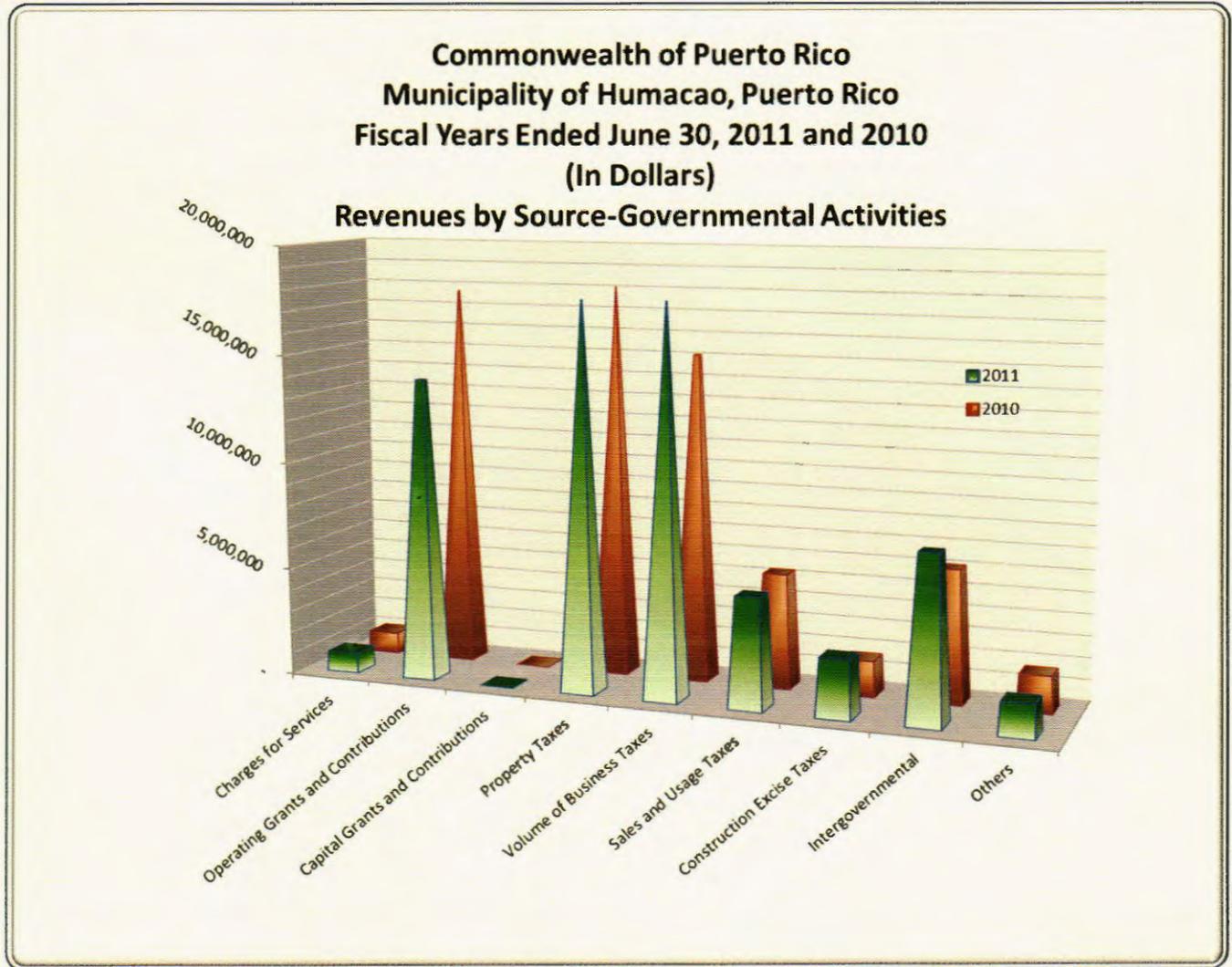
**Commonwealth of Puerto Rico  
Municipality of Humacao, Puerto Rico  
Change in Net Assets  
For the Fiscal Years Ending June 30,**

|                                    | 2011                  | 2010                  |
|------------------------------------|-----------------------|-----------------------|
| <b>Revenues:</b>                   |                       |                       |
| Program Revenues:                  |                       |                       |
| Changes for Services               | \$ 936,384            | \$ 981,430            |
| Operating Grants and Contributions | 11,920,257            | 17,030,051            |
| Capital Grants and Contributions   | -                     | -                     |
| General Revenues:                  |                       |                       |
| Property Taxes                     | 17,790,262            | 18,102,922            |
| Volume of Business Taxes           | 17,833,289            | 15,108,458            |
| Sales and Usage Taxes              | 5,109,376             | 5,307,665             |
| Construction Excise Taxes          | 2,708,153             | 1,658,842             |
| Intergovernmental                  | 7,626,100             | 6,121,083             |
| Other General Revenues             | 1,535,360             | 1,715,651             |
| <b>Total Revenues</b>              | <b>65,459,181</b>     | <b>66,026,102</b>     |
| <b>Expenses:</b>                   |                       |                       |
| General Administration             | 20,378,309            | 22,765,241            |
| Public Safety                      | 3,678,918             | 2,985,622             |
| Public Works                       | 4,768,213             | 4,457,639             |
| Culture and Recreation             | 2,861,781             | 2,634,995             |
| Health and Sanitation              | 1,715,105             | 1,715,105             |
| Public Instruction                 | 10,098,324            | 9,423,876             |
| Solid Waste Disposal               | 3,023,882             | 2,832,598             |
| Human Services and Welfare         | 8,575,380             | 6,973,604             |
| Urban Development                  | 5,909,711             | 8,379,775             |
| Interest Costs                     | 2,461,574             | 1,616,089             |
| <b>Total Expenses</b>              | <b>63,471,197</b>     | <b>63,784,544</b>     |
| <b>Changes in Net Assets</b>       | <b>1,987,984</b>      | <b>2,241,558</b>      |
| Net Assets-Beginning               | 123,039,048           | 120,797,490           |
| <b>Net Assets-Ending</b>           | <b>\$ 125,027,032</b> | <b>\$ 123,039,048</b> |

With respect to prior year, revenues decreased by approximately \$567 thousand or 0.43%, principally due to a decrease in operating grants and contributions for approximately \$3.8 million due to the fact that last year's federal grants for general administration were significantly more than this year, this decrease was partially offset by an increase of volume of business taxes (\$2.7 millions) and intergovernmental (\$1.5 million).

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

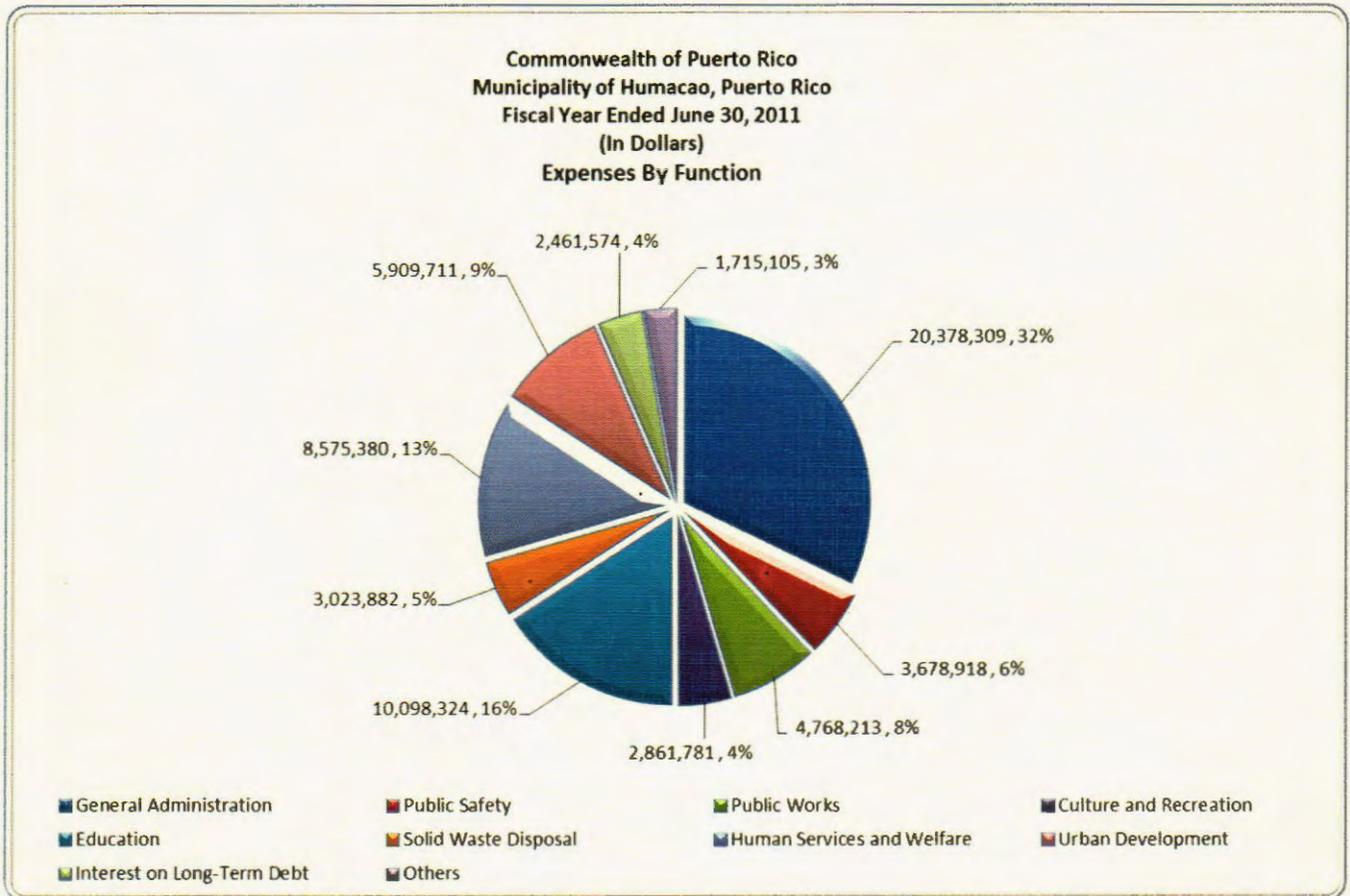
FIGURE 1



Approximately 26% of the Municipality's revenues came from property taxes and volume of business taxes, 21% from operating grants and contributions, 11% from intergovernmental revenue, and 16% from other sources. The Municipality's expenses cover a range of services. The largest expenses are general administration with 35%, education with 18%, human services and welfare with 15%, and public works with 8%. Program revenues of the Municipality covered 23% of total expenses.

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2010-2011:

FIGURE 2



Expenses decreased 0.25% or \$313,347 in comparison with 2010 year, principally in general administration.

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

**Table 3**

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

| Functions/Programs         | Total Cost of Services |                      | Net Cost of Services |                      |
|----------------------------|------------------------|----------------------|----------------------|----------------------|
|                            | 2011                   | 2010                 | 2011                 | 2010                 |
| General Administration     | \$ 20,378,309          | \$ 22,765,241        | \$ 19,780,740        | \$ 16,903,985        |
| Public Safety              | 3,678,918              | 2,985,622            | 3,678,918            | 2,985,622            |
| Public Works               | 4,768,213              | 4,457,639            | 4,768,213            | 4,457,639            |
| Culture and Recreation     | 2,861,781              | 2,634,995            | 2,861,781            | 2,634,995            |
| Public Instruction         | 10,098,324             | 9,423,876            | 2,499,191            | 686,685              |
| Solid Waste Disposal       | 3,023,882              | 2,832,598            | 3,023,882            | 2,832,598            |
| Human Services and Welfare | 8,575,380              | 6,973,604            | 6,535,852            | 5,176,632            |
| Urban Development          | 5,909,711              | 8,379,775            | 4,216,699            | 6,393,661            |
| Interest on Long-Term Debt | 2,461,574              | 1,616,089            | 2,461,574            | 1,616,089            |
| Others                     | 1,715,105              | 1,715,105            | 787,706              | 738,579              |
| <b>Total</b>               | <b>\$ 63,471,197</b>   | <b>\$ 63,784,544</b> | <b>\$ 50,614,556</b> | <b>\$ 44,426,485</b> |

Some of the cost of governmental activities in 2011 was paid by those who directly benefited from the programs (\$936,384) and other governments and organizations that subsidized certain programs with grants and contributions (\$11,920,257). The \$50,614,556 net cost of services was substantially covered by other general revenues including property, volume of business license taxes, sales and usage taxes and intergovernmental.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. Municipality implemented **GASB Statement 54, Fund Balance Reporting and Governmental Fund Type Definitions** effective with the June 30, 2011 financial statements. Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent. The June 30, 2010 fund balances were reclassified as per new standard for comparative purposes.

**Table 4**

**Commonwealth of Puerto Rico**  
**Municipality of Humacao, Puerto Rico**  
**Fund Balance**  
**As of June 30,**

|                       | <u>2011</u>                 | <u>2010</u>                 |
|-----------------------|-----------------------------|-----------------------------|
| <b>Fund Balances:</b> |                             |                             |
| Nonexpendable         | \$ -                        | \$ -                        |
| Restricted            | 34,633,878                  | 50,768,065                  |
| Committed             | 822,043                     | 353,538                     |
| Assigned              | 3,986,567                   | 3,301,458                   |
| Unassigned            | 12,468,311                  | 8,313,185                   |
| <b>Total</b>          | <b><u>\$ 51,910,799</u></b> | <b><u>\$ 62,736,246</u></b> |

In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the Fiscal year ended June 30, 2011, the governmental funds reported combined ending fund balances of \$51,910,799, a net decrease of \$10,825,447 in comparison with the prior year. This decrease was caused primarily because of the consumption of restricted fund balances for the construction of Multiple Uses Coliseum. Of total combined fund balances, \$12,468,311 (24%) constitutes unreserved fund balance of general fund. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents approximately 86% of total ending general fund balance. For the year ended June 30, 2011, the fund balance of the general fund increased by \$3.9 million when compared with the prior year, mainly due to an increase of \$2.7 million on volume of business taxes.

Table 5

**Government of Puerto Rico**  
**Municipality of Humacao, Puerto Rico**  
**General Fund**  
**As of June 30,**

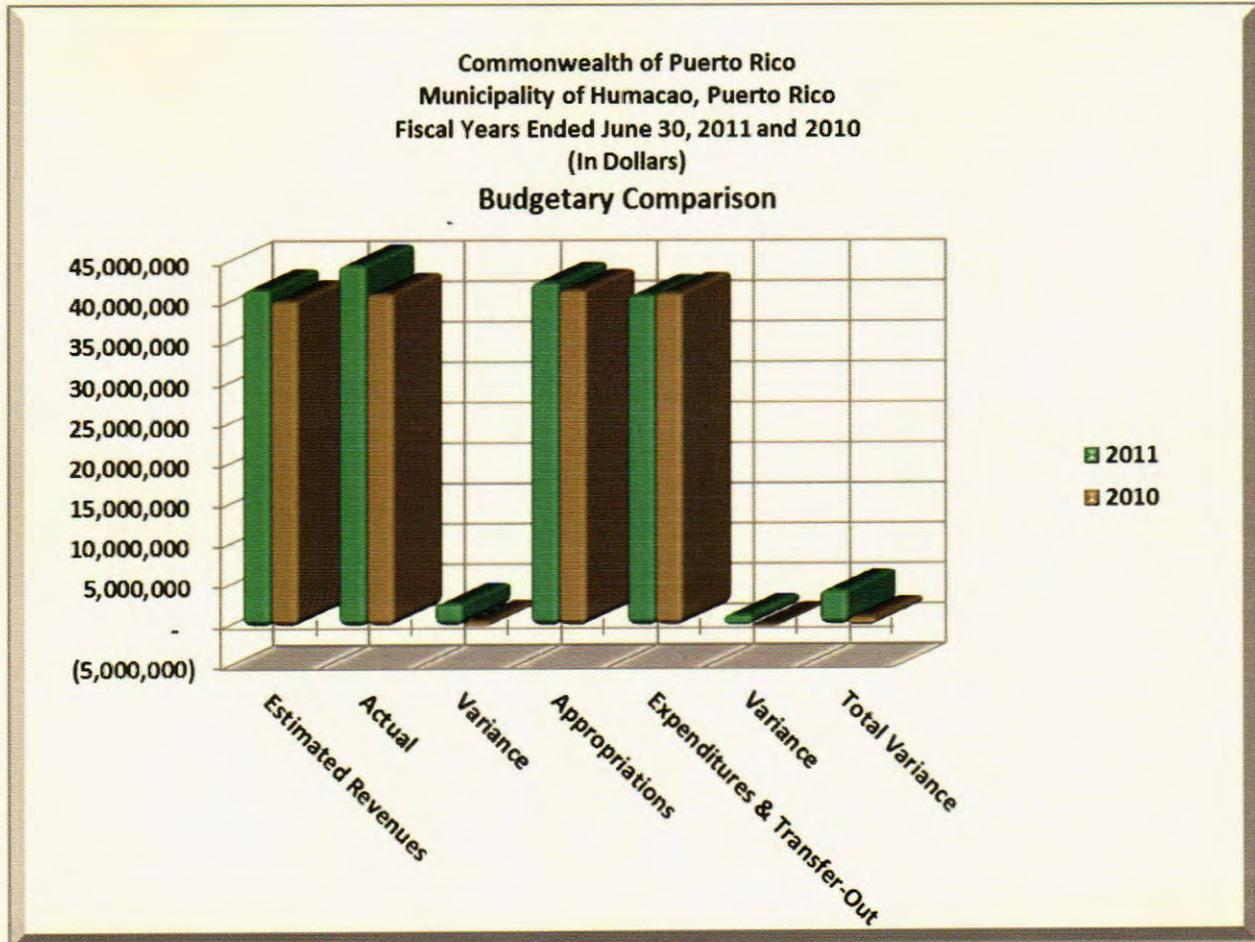
| Description                         | <u>2011</u>                | <u>2010</u>             |
|-------------------------------------|----------------------------|-------------------------|
| <b>Revenues:</b>                    |                            |                         |
| Property Taxes                      | \$ 12,805,232              | \$ 13,341,946           |
| Volume of Business Taxes            | 17,833,289                 | 15,108,458              |
| Sales and Usage Taxes               | 4,227,498                  | 4,360,417               |
| Construction Excise Taxes           | 2,708,153                  | 1,658,842               |
| Intergovernmental                   | 5,251,690                  | 4,474,939               |
| Interests                           | 773,439                    | 1,188,048               |
| Charges for Service                 | 927,399                    | 976,526                 |
| Miscellaneous                       | <u>353,554</u>             | <u>373,091</u>          |
| Total Revenues                      | <u>44,880,254</u>          | <u>41,482,267</u>       |
| <b>Expenditures:</b>                |                            |                         |
| General Government                  | 20,348,275                 | 21,839,814              |
| Public Safety                       | 3,272,994                  | 2,517,521               |
| Public Work                         | 3,821,654                  | 3,023,090               |
| Culture and Recreation              | 1,952,752                  | 1,779,196               |
| Health and Sanitation               | 1,715,105                  | 1,715,105               |
| Solid Waste Disposal                | 3,023,882                  | 2,832,598               |
| Human Services and Welfare          | 5,264,545                  | 4,545,508               |
| Urban Development                   | 989,031                    | 968,368                 |
| Capital Outlay                      | <u>295,439</u>             | <u>1,076,899</u>        |
| Total Expenditures                  | <u>40,683,677</u>          | <u>40,298,099</u>       |
| Net Transfer In (Out)               | (251,308)                  | (1,136,231)             |
| Other Financing Sources             | <u>-</u>                   | <u>-</u>                |
| <b>Net Increase in Fund Balance</b> | <b><u>\$ 3,945,269</u></b> | <b><u>\$ 47,937</u></b> |

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The general fund original budget for the fiscal period 2010-2011 presented a decrease of 1.6% with respect to prior year budget. During the fiscal year budget revenues were increased by \$2,996,374 mainly due to excess in volume of business taxes, but the Municipality did not include it as an amendment to the original budget. Budget expenditures were amended during the year in accordance with functions estimates.

A positive variance of \$1,560,436 between final budget and actual expenditures was due mainly to economies in some functions. The Municipality reported more expenditures than appropriations in those functions on payments for purchase of supplies, equipment, and professional and nonprofessional services.

FIGURE 3



**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital Assets**

At the end of the fiscal year, the Municipality has invested \$140,434,758 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of \$18.5 million or over 7% from the prior year.

The Municipality invested a total of \$16,900,402 in capital assets during the fiscal year 2010-2011. Principal addition were as follows:

**Table 6**

**Commonwealth of Puerto Rico  
Municipality of Humacao, Puerto Rico  
Capital Assets, net  
As of June 30,**

|                                | Governmental Activities |                       |
|--------------------------------|-------------------------|-----------------------|
|                                | 2011                    | 2010                  |
| <b>Non-Depreciable Assets:</b> |                         |                       |
| Land                           | \$ 11,702,552           | \$ 11,702,391         |
| Construction in Progress       | 71,503,374              | 55,789,325            |
| <b>Depreciable Assets:</b>     |                         |                       |
| Buildings                      | 36,620,259              | 37,482,666            |
| Infrastructure                 | 17,172,739              | 17,532,226            |
| Motor Vehicles                 | 2,089,660               | 1,863,725             |
| Equipment                      | 1,346,174               | 1,674,793             |
| Capital Lease                  | -                       | 22,907                |
| <b>Total</b>                   | <b>\$ 140,434,758</b>   | <b>\$ 126,068,033</b> |

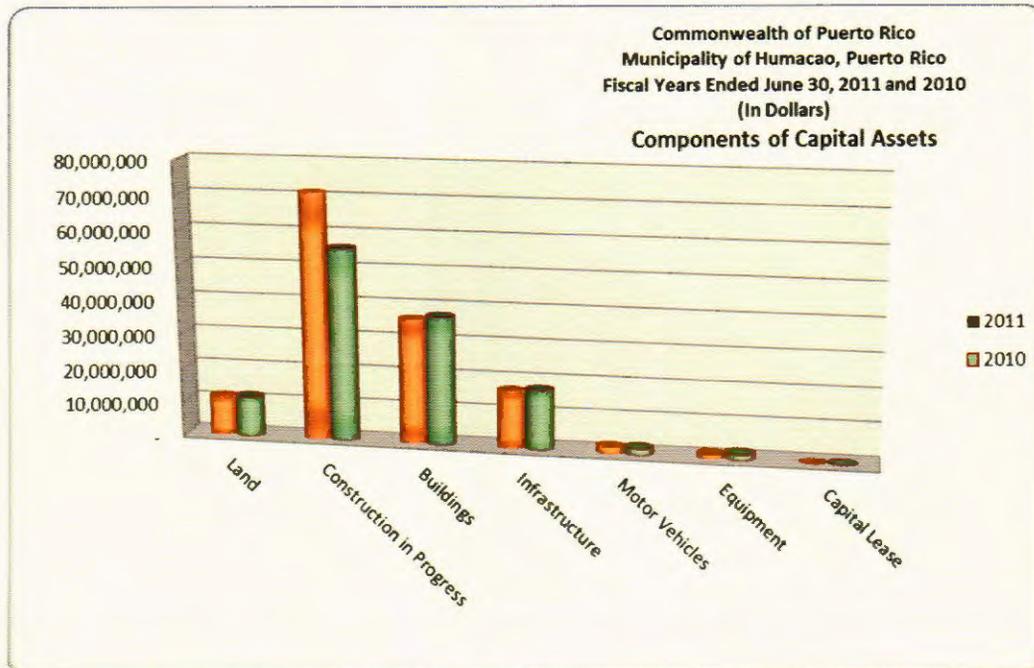
- Motor Vehicles acquisition - \$353,665
  - Construction in Progress – \$15,714,049
- The principal projects are the following:

- Multiple Use Coliseum
- Art Center

- Acquisition of Equipment – \$353,665

Other projects related to repair and maintenance of roads (not capitalized) and facilities was developed during the year 2011.

**FIGURE 4**



**Long-Term Debts**

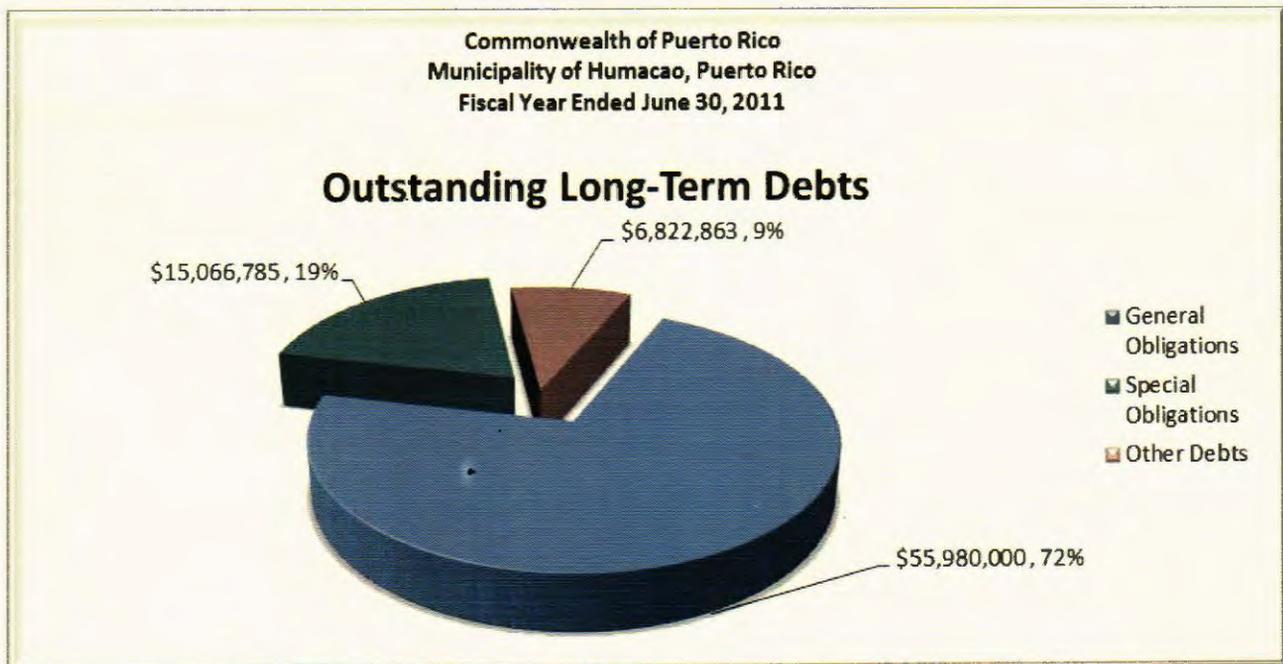
At year-end, the Municipality had \$68,361,000 in general and special bonds, a decrease of \$3.1 million. The following is a summary of the Municipality's outstanding debt as of June 30, 2011 and 2010:

**Table 6**

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

|                          | <b>Governmental Activities</b> |                      |
|--------------------------|--------------------------------|----------------------|
|                          | <b>2011</b>                    | <b>2010</b>          |
| General Obligation Bonds | \$ 55,980,000                  | \$ 57,640,000        |
| Special Obligation Bonds | 15,066,785                     | 14,508,289           |
| Capitalized Leases       | -                              | 14,241               |
| Others Debts             | 6,822,863                      | 7,886,484            |
| <b>Total</b>             | <b>\$ 77,869,648</b>           | <b>\$ 80,049,014</b> |

**FIGURE 5**



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

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2010-2011 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 20.5%, which compares with the Commonwealth rate of 14.9%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2011-2012 are \$44 million, approximately \$2.1 million more than the fiscal year 2010-2011. The Municipality expects an increase in revenues for the next year due to estimated income from State Governmental Agencies and Public Corporations. Budgeted expenditures are expected to stabilize accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with economic injection projected when the construction project promoted by the Municipality and other private projects developed during the year.

**AMERICAN RECOVERY AND REINVESTMENT ACT**

The Municipality received the following federal awards from the American Recovery and Reinvestment Act during fiscal year 2010-2011:

| Federal Program  | CFDA<br>Number | Total<br>Award             | Total<br>Expended        |
|--|----------------|----------------------------|--------------------------|
| Community Development Block Grant/Entitlement Grants - Cluster | 14.253         | \$ 420,401                 | \$ 321,382               |
| Homelessness Prevention and Rapid Re-Housing Program           | 14.257         | 642,921                    | 52,979                   |
| Child Care and Development Block Grant - Cluster               | 93.713         | 20,274                     | 11,254                   |
| Head Start Program - Cluster                                   | 93.708         | 374,316                    | 168,747                  |
| Early Head Start Program - Cluster                             | 93.709         | 86,286                     | 74,288                   |
| <b>Total</b>   |                | <b><u>\$ 1,544,198</u></b> | <b><u>\$ 628,650</u></b> |

**CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Finance Department at [(787) 852-2730] or P.O. Box 178, Humacao, Puerto Rico 00792.

**BASIC FINANCIAL STATEMENTS**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2011

|   | <u>GOVERNMENTAL<br/>ACTIVITIES</u> |
|---|------------------------------------|
| <b>ASSETS:</b>                                    |                                    |
| Cash and Investments                              | \$ 56,360,904                      |
| Cash with Fiscal Agent                            | 19,335,843                         |
| Receivables (net):                                |                                    |
| Property Taxes                                    | 72,995                             |
| Due from Governmental Units                       | 7,992                              |
| Federal Grants                                    | 7,497,957                          |
| Sales and Usage Taxes                             | 324,507                            |
| Total Current Assets                              | <u>83,600,198</u>                  |
| Deferred Charges                                  | <u>339,595</u>                     |
| Capital Assets:                                   |                                    |
| Land, Improvement and Construction in Progress    | 83,205,926                         |
| Other Capital Assets [Net of Depreciation]        | <u>57,228,832</u>                  |
| Total Capital Assets                              | <u>140,434,758</u>                 |
| <b>TOTAL ASSETS</b>                               | <b><u>224,374,551</u></b>          |
| <b>LIABILITIES:</b>                               |                                    |
| Accounts Payable and Accrued Expenses             | 664,926                            |
| Accrued Interest                                  | 1,133,297                          |
| Due to Governmental Units                         | 3,148,227                          |
| Deferred Revenues                                 | 16,531,421                         |
| Long-Term Liabilities:                            |                                    |
| Due Within One Year                               | 6,571,509                          |
| Due in More than One Year                         | <u>71,298,139</u>                  |
| <b>TOTAL LIABILITIES</b>                          | <b><u>99,347,519</u></b>           |
| <b>NET ASSETS:</b>                                |                                    |
| Investment in Capital Assets, Net of Related Debt | 87,977,155                         |
| Restricted for:                                   |                                    |
| Head Start  | 4,573,480                          |
| Debt Service                                      | 15,314,029                         |
| Community Development Projects                    | 1,585,499                          |
| Other Purposes                                    | 6,909,280                          |
| Unrestricted                                      | <u>8,667,589</u>                   |
| <b>TOTAL NET ASSETS</b>                           | <b><u>\$ 125,027,032</u></b>       |

See accompanying notes to Basic Financial Statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

| Functions/Programs                          | Expenses             | Program Revenues        |  |  | Net (Expense)<br>Revenues<br>(See Next Page) |
|---|----------------------|-------------------------|--|--|--|
|   |                      | Charges For<br>Services | Operating<br>Grants and<br>Contributions | Capital<br>Grants and<br>Contributions |  |
| <b>Governmental Activities:</b>             |                      |                         |  |  |  |
| Mayor and Municipal Legislature             | \$ 3,262,660         | \$ -                    | \$ -                                     | \$ -                                   | \$ (3,262,660)                               |
| General Government                          | 17,115,649           | 8,985                   | 588,584                                  | -                                      | (16,518,080)                                 |
| Public Safety                               | 3,678,918            | -                       | -  | -                                      | (3,678,918)                                  |
| Public Works                                | 4,768,213            | -                       | -  | -                                      | (4,768,213)                                  |
| Culture and Recreation                      | 2,861,781            | -                       | -  | -                                      | (2,861,781)                                  |
| Health and Sanitation                       | 1,715,105            | 927,399                 | -  | -                                      | (787,706)                                    |
| Public Instruction                          | 10,098,324           | -                       | 7,599,133                                | -                                      | (2,499,191)                                  |
| Solid Waste Disposal                        | 3,023,882            | -                       | -  | -                                      | (3,023,882)                                  |
| Human Services and Welfare                  | 8,575,380            | -                       | 2,039,528                                | -                                      | (6,535,852)                                  |
| Urban Development                           | 5,909,711            | -                       | 1,693,012                                | -                                      | (4,216,699)                                  |
| Interest on Long-Term Debt                  | 2,461,574            | -                       | -  | -                                      | (2,461,574)                                  |
| <b>Total Governmental Activities</b>        | <b>\$ 63,471,197</b> | <b>\$ 936,384</b>       | <b>\$ 11,920,257</b>                     | <b>\$ -</b>                            | <b>\$ (50,614,556)</b>                       |
| General Revenues:                           |                      |                         |  |  |  |
| Taxes:                                      |                      |                         |  |  |  |
| Property Taxes, levied for General Purposes |                      |                         |  |  | 12,805,232                                   |
| Property Taxes, levied for Debt Service     |                      |                         |  |  | 4,985,030                                    |
| Volume of Business Taxes                    |                      |                         |  |  | 17,833,289                                   |
| Sales and Usage Taxes                       |                      |                         |  |  | 5,109,376                                    |
| Construction Excise Taxes                   |                      |                         |  |  | 2,708,153                                    |
| Intergovernmental                           |                      |                         |  |  | 7,626,100                                    |
| Interest                                    |                      |                         |  |  | 1,190,791                                    |
| Miscellaneous                               |                      |                         |  |  | 344,569                                      |
| Total General Revenues                      |                      |                         |  |  | 52,602,540                                   |
| <b>CHANGES IN NET ASSETS</b>                |                      |                         |  |  | <b>1,987,984</b>                             |
| Net Assets – As Restated, Beginning of Year |                      |                         |  |  | 123,039,048                                  |
| <b>NET ASSETS – ENDING OF YEAR</b>          |                      |                         |  |  | <b>\$ 125,027,032</b>                        |

See accompanying notes to Basic Financial Statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

BALANCE SHEET – GOVERNMENTAL FUNDS

JUNE 30, 2011

|  | GENERAL<br>FUND      | HEAD START<br>FUND  | ART<br>CENTER<br>FUND | MULTIPLE USES<br>COLISEUM<br>FUND | DEBT<br>SERVICE<br>FUND | OTHER<br>GOVERNMENTAL<br>FUNDS | TOTAL<br>GOVERNMENTAL<br>FUNDS |
|--|----------------------|---------------------|-----------------------|-----------------------------------|-------------------------|--------------------------------|--------------------------------|
| <b>ASSETS:</b>                             |                      |                     |                       |                                   |                         |                                |                                |
| Cash and Cash Equivalents                  | \$ 29,372,877        | \$ 294,080          | \$ 8,928,329          | \$ 7,530,242                      | \$ -                    | \$ 10,235,376                  | \$ 56,360,904                  |
| Cash with Fiscal Agent                     | 5,500                | -                   | 38,650                | 1,168,769                         | 16,374,331              | 1,748,593                      | 19,335,843                     |
| Receivables:                               |                      |                     |                       |                                   |                         |                                |                                |
| Property Taxes                             | -                    | -                   | -                     | -                                 | 72,995                  | -                              | 72,995                         |
| Sales and Usage Taxes                      | 324,507              | -                   | -                     | -                                 | -                       | -                              | 324,507                        |
| Federal Grants                             | -                    | 4,862,260           | -                     | -                                 | -                       | 2,635,697                      | 7,497,957                      |
| Due from Other Funds                       | 2,262,906            | 282                 | -                     | -                                 | -                       | 75,977                         | 2,339,165                      |
| Due from Governmental Units                | 401                  | -                   | -                     | -                                 | -                       | 7,591                          | 7,992                          |
| <b>Total Assets</b>                        | <b>\$ 31,966,191</b> | <b>\$ 5,156,622</b> | <b>\$ 8,966,979</b>   | <b>\$ 8,699,011</b>               | <b>\$ 16,447,326</b>    | <b>\$ 14,703,234</b>           | <b>\$ 85,939,363</b>           |
| <b>LIABILITIES AND FUND BALANCES:</b>      |                      |                     |                       |                                   |                         |                                |                                |
| Liabilities:                               |                      |                     |                       |                                   |                         |                                |                                |
| Account Payable                            | \$ 541,231           | \$ 30,962           | \$ -                  | \$ -                              | \$ -                    | \$ 92,733                      | \$ 664,926                     |
| Bonds Payable                              | -                    | -                   | -                     | -                                 | 2,745,000               | -                              | 2,745,000                      |
| Account Interest                           | -                    | -                   | -                     | -                                 | 1,133,297               | -                              | 1,133,297                      |
| Due to Governmental Units                  | 381,384              | -                   | 2,766,843             | -                                 | -                       | -                              | 3,148,227                      |
| Due to Other Funds                         | 65,178               | 253,773             | -                     | 10,799                            | -                       | 2,009,415                      | 2,339,165                      |
| Deferred Revenues:                         |                      |                     |                       |                                   |                         |                                |                                |
| Volume of Business Tax                     | 16,531,421           | -                   | -                     | -                                 | -                       | -                              | 16,531,421                     |
| Federal Grants                             | -                    | 4,715,968           | -                     | -                                 | -                       | 2,750,560                      | 7,466,528                      |
| <b>Total Liabilities</b>                   | <b>17,519,214</b>    | <b>5,000,703</b>    | <b>2,766,843</b>      | <b>10,799</b>                     | <b>3,878,297</b>        | <b>4,852,708</b>               | <b>34,028,564</b>              |
| Fund Balances:                             |                      |                     |                       |                                   |                         |                                |                                |
| Restricted                                 | 221,325              | 155,919             | 6,200,136             | 8,688,212                         | 12,569,029              | 6,799,257                      | 34,633,878                     |
| Committed                                  | 813,019              | -                   | -                     | -                                 | -                       | 9,024                          | 822,043                        |
| Assigned                                   | 944,322              | -                   | -                     | -                                 | -                       | 3,042,245                      | 3,986,567                      |
| Unassigned                                 | 12,468,311           | -                   | -                     | -                                 | -                       | -                              | 12,468,311                     |
| <b>Total Fund Balances</b>                 | <b>14,446,977</b>    | <b>155,919</b>      | <b>6,200,136</b>      | <b>8,688,212</b>                  | <b>12,569,029</b>       | <b>9,850,526</b>               | <b>51,910,799</b>              |
| <b>Total Liabilities and Fund Balances</b> | <b>\$ 31,966,191</b> | <b>\$ 5,156,622</b> | <b>\$ 8,966,979</b>   | <b>\$ 8,699,011</b>               | <b>\$ 16,447,326</b>    | <b>\$ 14,703,234</b>           | <b>\$ 85,939,363</b>           |

See accompanying notes to Basic Financial Statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF NET ASSETS

JUNE 30, 2011

**Total Fund Balances – Government Funds (Page 19)** **\$ 51,910,799**

Amount reported for Governmental Activities in the Statement of Net Assets (Page 17)  
are different because:

Capital Assets used in governmental activities are not financial resources and therefore  
are not reported in the funds. In the current period, these amounts are:

|                                |                     |             |
|--------------------------------|---------------------|-------------|
| Non Depreciable Capital Assets | \$ 83,205,926       |             |
| Depreciable Capital Assets     | 70,718,368          |             |
| Infrastructure Assets          | 23,111,300          |             |
| Accumulated Depreciation       | <u>(36,600,836)</u> |             |
| Total Capital Assets           |                     | 140,434,758 |

Other Assets used in governmental activities are not financial resources and therefore  
are not reported in the funds:

|                  |  |         |
|------------------|--|---------|
| Deferred Charges |  | 339,595 |
|------------------|--|---------|

Some of the **Municipality's** revenues will be collected after year-end but are not available  
soon enough to pay for the current period's expenditures and therefore are deferred in the funds:

|                          |                |           |
|--------------------------|----------------|-----------|
| CDBG Program             | 1,439,785      |           |
| Head Start Program       | 4,715,967      |           |
| Early Head Start Program | 469,645        |           |
| Other Major Fund         | <u>841,130</u> |           |
| Total Deferred Revenues  |                | 7,466,527 |

Some liabilities are not due and payable in the current period and therefore are not reported  
in the funds. Those liabilities consist of:

|                                      |                    |                     |
|--------------------------------------|--------------------|---------------------|
| General and Special Obligation Bonds | (68,301,786)       |                     |
| Law Number 146 - MRCC                | (613,577)          |                     |
| LIMS Debt - MRCC                     | (119,373)          |                     |
| Law Number 42 - MRCC                 | (428,743)          |                     |
| Claims and Judgments                 | (162,000)          |                     |
| Compensated Absences                 | <u>(5,499,168)</u> |                     |
| Total Long-Term Liabilities          |                    | <u>(75,124,647)</u> |

**Total Net Assets of Governmental Activities (Page 17)** **\$ 125,027,032**

See accompanying notes to Basic Financial Statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE – GOVERNMENTAL FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

|  | GENERAL<br>FUND      | HEAD START<br>FUND | ART<br>CENTER<br>FUND | MULTIPLE USES<br>COLISEUM<br>FUND | DEBT<br>SERVICE<br>FUND | OTHER<br>GOVERNMENTAL<br>FUNDS | TOTAL<br>GOVERNMENTAL<br>FUNDS |
|--|----------------------|--------------------|-----------------------|-----------------------------------|-------------------------|--------------------------------|--------------------------------|
| <b>REVENUES:</b>                       |                      |                    |                       |                                   |                         |                                |                                |
| Property Taxes                         | \$ 12,805,232        | \$ -               | \$ -                  | \$ -                              | \$ 4,985,030            | \$ -                           | \$ 17,790,262                  |
| Volume of Business Taxes               | 17,833,289           | -                  | -                     | -                                 | -                       | -                              | 17,833,289                     |
| Sales and Usage Taxes                  | 4,227,498            | -                  | -                     | -                                 | 881,878                 | -                              | 5,109,376                      |
| Federal Grants                         | -                    | 7,189,441          | -                     | -                                 | -                       | 8,109,992                      | 15,299,433                     |
| Intergovernmental                      | 5,251,690            | -                  | -                     | -                                 | -                       | 2,374,410                      | 7,626,100                      |
| Construction Excise Taxes              | 2,708,153            | -                  | -                     | -                                 | -                       | -                              | 2,708,153                      |
| Charges for Services                   | 927,399              | -                  | -                     | -                                 | -                       | -                              | 927,399                        |
| Interest                               | 773,439              | -                  | 208,675               | 208,677                           | -                       | -                              | 1,190,791                      |
| Miscellaneous                          | 353,554              | -                  | -                     | -                                 | -                       | -                              | 353,554                        |
| Total Revenues                         | <u>44,880,254</u>    | <u>7,189,441</u>   | <u>208,675</u>        | <u>208,677</u>                    | <u>5,866,908</u>        | <u>10,484,402</u>              | <u>68,838,357</u>              |
| <b>EXPENDITURES:</b>                   |                      |                    |                       |                                   |                         |                                |                                |
| Current:                               |                      |                    |                       |                                   |                         |                                |                                |
| Mayor and Municipal Legislature        | 2,907,945            | -                  | -                     | -                                 | -                       | -                              | 2,907,945                      |
| General Government                     | 17,440,330           | -                  | -                     | -                                 | -                       | 229,586                        | 17,669,916                     |
| Public Safety                          | 3,272,994            | -                  | -                     | -                                 | -                       | 203,230                        | 3,476,224                      |
| Public Works                           | 3,821,654            | -                  | -                     | -                                 | -                       | 161,119                        | 3,982,773                      |
| Culture and Recreation                 | 1,952,752            | -                  | -                     | -                                 | -                       | 174,263                        | 2,127,015                      |
| Health and Sanitation                  | 1,715,105            | -                  | -                     | -                                 | -                       | -                              | 1,715,105                      |
| Public Instruction                     | -                    | 7,466,594          | -                     | -                                 | -                       | 2,631,730                      | 10,098,324                     |
| Solid Waste Disposal                   | 3,023,882            | -                  | -                     | -                                 | -                       | -                              | 3,023,882                      |
| Human Services and Welfare             | 5,264,545            | -                  | -                     | -                                 | -                       | 3,184,151                      | 8,448,696                      |
| Urban Development                      | 989,031              | -                  | -                     | -                                 | -                       | 4,819,333                      | 5,808,364                      |
| Capital Outlay                         | 295,439              | -                  | 4,589,934             | 11,085,940                        | -                       | 929,089                        | 16,900,402                     |
| Debt Service:                          |                      |                    |                       |                                   |                         |                                |                                |
| Principal                              | -                    | -                  | -                     | -                                 | 3,056,080               | -                              | 3,056,080                      |
| Interest and Other Charges             | -                    | -                  | -                     | -                                 | 2,461,574               | -                              | 2,461,574                      |
| Total Expenditures                     | <u>40,683,677</u>    | <u>7,466,594</u>   | <u>4,589,934</u>      | <u>11,085,940</u>                 | <u>5,517,654</u>        | <u>12,332,501</u>              | <u>81,676,300</u>              |
| Excess of Revenues Over (Under)        |                      |                    |                       |                                   |                         |                                |                                |
| Expenditures                           | <u>4,196,577</u>     | <u>(277,153)</u>   | <u>(4,381,259)</u>    | <u>(10,877,263)</u>               | <u>349,254</u>          | <u>(1,848,099)</u>             | <u>(12,837,943)</u>            |
| <b>OTHER FINANCING SOURCES (USES):</b> |                      |                    |                       |                                   |                         |                                |                                |
| Proceed of Bonds                       | -                    | -                  | -                     | -                                 | -                       | 2,012,496                      | 2,012,496                      |
| Transfers – In                         | 198,291              | -                  | 41,105                | 43,513                            | 351,385                 | 114,648                        | 748,942                        |
| Transfers – Out                        | (449,599)            | -                  | -                     | (16,434)                          | -                       | (282,909)                      | (748,942)                      |
| Total Other Financing Sources and Uses | <u>(251,308)</u>     | <u>-</u>           | <u>41,105</u>         | <u>27,079</u>                     | <u>351,385</u>          | <u>1,844,235</u>               | <u>2,012,496</u>               |
| Net Change in Fund Balances            | <u>3,945,269</u>     | <u>(277,153)</u>   | <u>(4,340,154)</u>    | <u>(10,850,184)</u>               | <u>700,639</u>          | <u>(3,864)</u>                 | <u>(10,825,447)</u>            |
| Fund Balances, As Restated – Beginning | 10,501,708           | 433,072            | 10,540,290            | 19,538,396                        | 11,868,390              | 9,854,390                      | 62,736,246                     |
| <b>FUND BALANCES – ENDING</b>          | <u>\$ 14,446,977</u> | <u>\$ 155,919</u>  | <u>\$ 6,200,136</u>   | <u>\$ 8,688,212</u>               | <u>\$ 12,569,029</u>    | <u>\$ 9,850,526</u>            | <u>\$ 51,910,799</u>           |

*OK along  
3/24/2011*

See accompanying notes to Basic Financial Statements

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Net Change in Fund Balances – Government Funds (Page 21) \$ (10,825,447)

Amount reported for Governmental Activities in the Statement of Activities (Page 18)  
are different because:

Governmental funds report capital outlays as expenditures. However, in the Statement of  
Activities the cost of those assets is allocated over their estimated useful lives and reported  
as depreciation expense. In the current period, these amounts are:

|  |               |            |
|--|---------------|------------|
| Urban Development and Capital Outlay               | \$ 16,900,402 |            |
| Depreciation Expense                               | (2,533,677)   |            |
| Excess of Capital Assets over Depreciation Expense |               | 14,366,725 |

Repayment of long-term principal is an expenditure in the governmental funds, but the repayment  
reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the  
repayments were 3,056,080

Bonds proceeds provide current financial resources to governmental funds, but issuing debt  
increases Long-Term Liabilities in the Statement of Net Assets. In the current period,  
proceeds received was (2,012,496)

Governmental Fund Report the effect of Bond Issuance Costs as Expenditure when Debt is first  
issued, and amortized in the Statement of Activities. This amounts is the effect of these differences:  
Amortization of Deferred Charges (28,484)

Revenues in the Statement of Activities that do not provide current financial resources are not  
reported as revenues in the funds:

|                                   |             |             |
|-----------------------------------|-------------|-------------|
| Community Development Block Grant | (192,983)   |             |
| Head Start Program                | (256,710)   |             |
| Other Funds                       | (2,929,483) |             |
| Total Revenues                    |             | (3,379,176) |

Some expenses reported in the Statement of Activities do not require the use of current  
financial resources and therefore are not reported as expenditures in governmental funds.

These activities consist of:

|                                  |           |         |
|----------------------------------|-----------|---------|
| Decrease in Property Taxes Debt  | 730,827   |         |
| Increase in Claims and Judgments | (162,000) |         |
| Decrease in Capital Lease        | 14,241    |         |
| Decrease in Compensated Absences | 227,714   |         |
| Total Additional Expenses        |           | 810,782 |

Change in Net Assets of Governmental Activities (Page 18) \$ 1,987,984

## 1. FINANCIAL REPORTING ENTITY

The accompanying financial statements present information on the financial activities of the Municipality of Humacao, Puerto Rico (Municipality) over which the Mayor and the Municipal Legislature, have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (USGAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statement have been implemented for the year ended June 30, 2011:

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*

GASB Statement No. 59, *Financial Instruments Omnibus* (The Municipality does not have financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice that should be affected by this Statement.)

### A. Organization

The Municipality was founded in the year 1793, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 16 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services. As a government entity, the Municipality is exempt from both federal and state taxes.

### B. Reporting Entity

A reporting entity is comprised of (1) the primary government, (2) component unit organizations for which the primary government is financial accountable (blended component units), and (3) other organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and they are financially accountable to the primary government (discrete component units). The primary government consists of all funds, departments, boards and agencies that are not legally separate from the Municipality and for which the Municipality is financial accountable.

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. GASB Accounting Standards Codification Section 2600, *Reporting Entity and Component Unit Presentation and Disclosure*, requires the inclusion of organizations that raise and hold funds for the direct benefit of the primary government.

GASB Accounting Standards Codification Section 2100, *Defining the Financial Reporting Entity*, describes the criteria for determining which organizations, functions, and activities should be considered part of the Municipality for financial reporting purposes. The primary criteria include appointing a voting majority of an organization's governing body, and the Municipality's ability to impose its will on that organization or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balance; and discrete – presentation of the component unit's financial data in column separate from the Municipality's balances and transactions.

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the Municipality indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the Municipality as the reporting entity.

1. FINANCIAL REPORTING ENTITY (continuation)

B. Reporting Entity (continuation)

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2011, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Statement Presentation

The basic financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America as applicable to local governmental units (USGAAP). The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements, which provide a more detailed level of financial information. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as governmental type.

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

**Management's Discussion and Analysis**

Management's discussion and analysis is required supplementary information that introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.

**Government-wide Financial Statements (GWFS)**

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

The focus of the *Statement of Net Assets* is designed to be similar to bottom line results for the Municipality's governmental activities and business type activities. This statement combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations. The *Statement of Net Assets* presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are restricted when constraints are placed on them that are imposed by external parties or by laws or regulations. Designations solely imposed by the Municipality's management are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, the Municipality's policy is to use the restricted resources first.

The *Statement of Activities* demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. In addition, to the extent that indirect costs are allocated to the various functions, the program expenses will include both direct and indirect costs. *Program Revenues* include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment, and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items properly excluded from program revenues are reported instead as *general revenues*.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

**Governmental Funds Financial Statements (GFFS)**

The GFFS [the *Balance Sheet*, and the *Statement of Revenues, Expenditures and Changes in Fund Balance*] provide information about the Municipality's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on major funds, rather than the previous financial model's fund types. This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (1) demonstrate legal and covenant compliance, (2) demonstrate the source and use of liquid resources, and (3) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the GFFS are presented in different measurement focus and basis of accounting than the GWFS, reconciliation is presented and separate explanation for each differences.

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

**Notes to the Basic Financial Statements**

The notes to the financial statements provide information that is essential to a user's full understanding of the data provided in the basis financial statements

**Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information. This section includes a *Budgetary Comparison Schedule – General Fund*, which includes reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund as presented in the GFFS.

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

**Government-wide Financial Statements**

The GWFS are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary funds. Subject to the additional rules and limitations detailed below, revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. The accompanying GWFS include exchange-like transactions such as license fees, fines, penalties, forfeitures, permits, charges for services, and most miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received.

The Municipality groups its non-exchange transactions into the following four classes in the basic financial statements:

*Derived Tax Revenues* – in this revenue, which result from assessments that the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

### **Government-wide Financial Statements**

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

*Government Mandated Non-exchange Transactions* – in this revenue (such as intergovernmental grants and contributions), receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For part of the grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Therefore, revenue is generally recognized as qualifying reimbursable expenditures are incurred.

*Voluntary Non-exchange Transactions* – in this revenue (such as donations and certain grants and entitlements) receivables and revenues are generally accounted for in the same manner as government mandated non-exchange transactions discussed above.

Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues.

### **Governmental Funds Financial Statements**

The GFFS are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For these purposes, the Municipality considers revenues to be available if they are collected within sixty (60) days after the end of the current fiscal period. Significant revenues subject to accrual include federal grants and sales and usage taxes. Revenues that the Municipality earns by incurring obligations are recognized in the same period as when the obligations are recognized. At June 30, 2011, all revenues sources met this availability criterion.

Property taxes, volume of business taxes, licenses and permits, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the Municipality.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to Section N50 of the GASB Codification *Nonexchange Transactions*, (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

In a manner similar to GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange, exchange-like transactions are also generally recorded when the exchange takes place while all revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded when an enforceable legal claim arises or when all eligibility requirements imposed by the provider have been met, applicable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

*Governmental Funds Financial Statements (continuation)*

The Municipality generally accrues a governmental fund liability and expenditures (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. The accompanying balance sheet – governmental funds generally reflects only assets that will not be converted into cash to satisfy current liabilities. Long-Term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds. Modifications to the accrual basis of accounting include:

- 1) Principal and interest on bonds payable are recorded when they matured (when payment is due), except for principal and interest of bonds due on July 1, 2011, which are recorded as governmental fund liabilities of June 30, 2011 which is the date when resources were available in the debt service fund.
- 2) Obligations from compensated absences and the estimated liability for municipal solid waste landfill post-closure care costs are recorded only when they mature (when payment is due).
- 3) Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (unmatured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying *Statement of Net Assets*. Such liabilities are recorded in the governmental funds when they mature.
- 4) Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying *Statement of Activities*, but are not recorded in the accompanying GFFS.

The Municipality reports the following major governmental funds:

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

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

Art Center Fund – This is used to account for the construction of the Art Center in Humacao, Puerto Rico.

Multiple Uses Coliseum Fund – This is used to account for the construction of the Multiple Uses Coliseum in Humacao, Puerto Rico.

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

The non-major funds are combined in a single column in the GGFS. As a general rule the effect of interfund activity has been eliminated from the GWFS.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

C. Stewardship, Compliance, and Accountability

**Budgetary Information**

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

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

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

The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the Budgetary Comparison Schedule – General Fund:

**Original Budget**

- 1) Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
- 2) The budget document is available for public inspection prior to its approval by the Municipal Legislature.
- 3) The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
- 4) Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance to be effective on July 1.

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

**Final Budget**

The final budgetary data presented in the Budgetary Comparison Schedule – General Fund reflects the following changes to the original budget:

- 1) Certain annual appropriations are budgeted on a project basis. If such projects are not completed at the end of the fiscal year, unexpended appropriations, including encumbered funds, and unexpended grant appropriations, are carried forward to the following year. In certain circumstances, other regular annual appropriations may be carried forward after appropriate approval. Annually appropriated funds, not authorized to be carried forward, lapse at the end of the fiscal year. Appropriations carried forward from the prior year are included in the final budgetary data.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

### *Final Budget (continuation)*

- 2) Appropriations may be adjusted during the year with the approval of the Mayor and the Municipal Legislature, e.g. supplemental appropriations. Additionally, the Mayor is authorized to make certain transfer of surplus within the departments. Such adjustments are reflected in the final budgetary data.

The Annual Appropriation Ordinance adopts the budget at the character level of expenditure within departments. As described above, the Mayor is authorized to make certain transfers of appropriations within departments. Accordingly, the legal level of budgetary control by the Municipal Legislature is the department Level.

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

- 1) Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
- 2) Interfund transactions of the General Fund are not included in the budgetary basis.
- 3) Certain accrued liabilities and other debts are not included in the budgetary basis.
- 4) Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

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

### **D. Assets, Liabilities, and Net Assets**

#### **1) Cash and Investment, and Cash with Fiscal Agent**

The Municipality's cash and investment are composed of demand deposits in commercial banks, demand deposits in the Governmental Development Bank of Puerto Rico (GDB), and cash equivalents in commercial banks. The Municipality has adopted the *Statement of Uniform Investment Guidelines for the Municipalities of the Government of Puerto Rico*, issued by the GDB as promulgated by Law No. 113 of August 3, 1995. The Finance Director of the Municipality, follow the guidelines, is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and interest bearing commercial bank accounts are recognized as revenue in the General Fund, Art Center Fund and in Multiuses Coliseum Fund in accordance with amount invested. Cash in the Special Revenue and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent in the Debt Service Fund represents special additional property tax collections retained by the Government, deposit in the GDB and restricted for the payment of the Municipality's debt service, as established by law. Cash with fiscal agent in other governmental funds consists of undisbursed proceeds of certain bonds and notes issued for the acquisition and construction of major capital improvements, or grants which are maintained in a cash custodian account by the GDB. This sinking fund is maintained by the GDB, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continuation)

**2) Receivables and Payables**

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

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

Receivables consist of all revenues earned but not collected at June 30, 2011. These account receivables are shown net of estimated allowances for uncollectible accounts, which are determined upon past collection experience, historical trends, and current economic conditions. Intergovernmental receivables in the general fund represent mostly sales and usage taxes, federal grant and contributions, property tax accounts that are levied by Municipal Revenue Collection Center (MRCC), a governmental entity created by the Government. Intergovernmental receivables in the other governmental funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded grant and contributions and state appropriations, and the amount in the debt service fund represents the distribution of property tax collected which is restricted for the debt service.

**3) Inventories**

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

**4) Deferred Charges**

Deferred charges in the accompanying *Statement of Net Assets* consist of bond issuance costs, net of accumulated amortization. Deferred charges are amortized over the term of the related debt using the straight-line method. In the GFFS, bond issuance costs are recorded in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

**5) Capital Assets**

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

5) Capital Assets (Continuation)

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

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

| CAPITAL ASSETS                   | YEARS |
|----------------------------------|-------|
| Buildings                        | 50    |
| Improvement Other Than Buildings | 50    |
| Infrastructure                   | 10-50 |
| Equipment                        | 10    |
| Furniture                        | 10    |
| Vehicles                         | 5     |
| Machinery                        | 5-10  |

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

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

The Municipality classifies as capital leases all lease agreements that involve the transfer of substantially all benefits and risks inherent in the ownership of the leased property and meet one or more of the following four criteria: (1) by the end of the lease term, the ownership of the leased property is transferred to the Municipality, (2) the lease agreement contains a bargain purchase option, (3) the lease term is substantially equal (75 percent or more) to the estimated useful life of the leased property, and (4) at the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90 percent or more of the estimated fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond one fiscal year, most capital lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Leases that meet at least one of the aforementioned four criteria and have a fiscal funding or a cancellation clause have been recorded as capital leases in the accompanying *Statement of Net Assets*, since the likelihood of invoking the provision is considered remote. The Municipality's lease agreements do not include contingent rental payments no escalation clauses.

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

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

### 1) *Deferred and Unearned Revenues*

In the GWFS, deferred revenues arise only when the Municipality receives resources before it has a legal claim to them. In the GFFS, arises when one of the following situations occur: (1) potential revenue does not meet both the measurable and available criteria for revenue recognition in the current period (unavailable revenue), and (2) the Municipality receives resources before it has a legal claim to them (unearned revenue).

### 2) *Long-Term Obligations, Bonds Issuance Costs, and Premium or Discount*

The liabilities reported in the GWFS include the general and special obligation bonds, long-term notes, other long-term liabilities (e.g., vacation, sick leave, claims and judgments, long-term liabilities to other governmental entities and third parties. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

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

### 3) *Compensated Absences*

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed at the current rate. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Municipality accrued a liability for compensated absences, which meet the following criteria: (1) the Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered; (2) the obligation relates to rights that vest or accumulate; (3) payment of the compensation is probable; and (4) the amount can be reasonably estimated.

In accordance with the above criteria and requirements in conformance with GASB Accounting Standards Codification Section C60, *Compensated Absences*, the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation and sick leave pay using salary rates effective at June 30, 2011. All vacation pay is accrued when incurred in the GWFS and PFFS. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

4) *Claims and Judgments*

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

5) *Accounting for Pension Costs*

The Municipality adopted the provisions of GASBS No. 50, *Pension Disclosure*, which amended GASBS No. 27, *Accounting for Pensions by State and Local Governments Employers*, by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

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

For the purpose of applying the requirements of GASB Accounting Standards Codification Section Pe5, *Pension Plans – Defined Benefit*, the State Government is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multiemployer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Government and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government.

6) *Net Assets/Fund Balance*

A) *Net Assets*

The GWFS and Proprietary Funds Financial Statements utilize a net assets presentation, which are categorized as follow:

- *Invested in Capital Assets, Net of Related Debt* – These consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvements of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvements of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs. In addition, the outstanding debt attributed to capital assets does not include accrued interest payable, non-capital accrued liabilities, inter-fund loans and other financial assets. Net assets invested in capital assets, net of related debt is comprised of the following:

|  | <u>Governmental<br/>Activities</u> |
|--|------------------------------------|
| Capital Assets, Net of Accumulated Depreciation .....      | \$140,434,758                      |
| Outstanding Balance on Related Debt.....                   | (71,046,785)                       |
| Unspent Capital Debt Proceeds.....                         | <u>18,589,182</u>                  |
| Total Invested in Capital Assets, Net of Related Debt..... | <u>\$ 87,977,155</u>               |

- *Restricted Net Assets* – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

### A) *Net Assets (continuation)*

- *Unrestricted Net Assets* – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

### B) *Fund Balance*

The Municipality implemented **GASB Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions*** effective with the June 30, 2011 financial statements. Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent.

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

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

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

In February 2009, the Governmental Accounting Standards Board ("GASB") issued **Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions (GASB 54)***. This new standard has substantially altered the categories and terminology used to describe the fund balance in governmental funds. The purpose of **GASB 54** is to provide the clarity to understand the extent of restrictions on the use of balance of the funds presented in the financial statements. One objective of this standard was to improve, including the understandability, the usefulness of fund balance information by providing clear fund balance classifications. **GASB 54** abandons the reserved, unreserved, and designated classifications of fund balance and replaced them with five classifications: nonspendable, restricted, committed, assigned, and unassigned. The requirements of this statement are effective for the Municipality's financial statements for the fiscal year ending June 30, 2011.

**GASB 54** requires local governments to focus on the constraints imposed upon resources when reporting fund balance in governmental funds. The fund balance classifications indicate the level of constraints placed upon how resources can be spent and identify the sources of those constraints. The following five classifications serve to inform readers of the financial statements of the extent to which the Municipality is bound to honor constraints on the specific purposes for which resources in a fund can be spent.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

### *Comprehensive Fund Balance Policy (continuation)*

- *Nonspendable Fund Balance* – Fund balance reported as “nonspendable” represents fund balance that is (a) not in a spendable form such as prepaid items or (b) legally or contractually required to be maintained intact such as an endowment.
- *Restricted Fund Balance* – Fund balance reported as “restricted” consists of amounts that can be spent only on the specific purposes stipulated by law or by the external providers of those resources.
- *Committed Fund Balance* – Fund balance reported as “committed” are self-imposed limitations set in place prior to the end of the fiscal period. These amounts can be used only for the specific purposes determined by a formal action of the Municipal Legislature, which is the highest level of decision-making authority, and that require the same level of formal action to remove the constraint.
- *Assigned Fund Balance* – Fund balance reported as “assigned” consists of amounts that are subject to a purpose constraint that represents an intended use established by the Municipal Legislature or by their designated official. The purpose of the assignment must be narrower than the purpose of the General Fund. Formal action is *not* necessary to impose, remove, or modify a constraint in Assigned Fund Balance. Additionally, this category is used to reflect the appropriation of a portion of existing fund balance to eliminate a projected deficit in the subsequent year’s budget.
- *Unassigned Fund Balance* – Fund balance reported as “unassigned” represents the residual classification of fund balance and includes all spendable amounts not contained within the other classifications.

### *Policy on Committing Funds*

In accordance with **GASB 54**, it is the policy of the Municipality that fund balance amounts will be reported as “Committed Fund Balance” only after formal action and approval by Municipal Legislature. The Municipal Legislature has the authority to separate funds for specific purposes. Any separate fund as Committed Fund Balance requires the adoption of a resolution by a simple majority of votes. The adoption of the resolution should be carried out before June 30 of the fiscal year to implement. If the actual amount of the commitment is not available through June 30, the resolution should establish the process of formula required to calculate the exact amount as soon as information is available in the following fiscal year.

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

It is the policy of the Municipality that the Municipal Legislature may commit fund balance for any reason that is consistent with the definition of Committed Fund Balance contained within **GASB 54**. Examples of reasons to commit fund balance would be to display intentions to use portions of fund balance for future capital projects, stabilization funds, or to earmark special General Fund streams unspent at year-end that are intended to be used for specific purposes.

After approval by the Municipal Legislature, the amount reported as Committed Fund Balance cannot be reversed without utilizing the same process required to commit the funds. Therefore, in accordance with **GASB 54**, it is the policy of the Municipality that funds can only be removed from the Committed Fund Balance category after motion and approval by the Municipal Legislature.

### *Policy on Assigning Funds*

In accordance with **GASB 54**, funds that are *intended* to be used for a specific purpose but have not received the formal approval action at the Municipal Legislature may be recorded as Assigned Fund Balance. Likewise, redeploying assigned resources to an alternative use does not require formal action by the Municipal Legislature.

Having reviewed the requirements for assigning fund balance, therefore, it is the policy of the Municipality that Major shall have the authority to assign fund balance of the Municipality based on intentions of use of funds by the Municipal Legislature. In addition, the Mayor can delegate to the Finance Director or other employee of the Municipality, the authority to assign the funds.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

**Policy on Unassigned General Fund Balance**

It is the goal of the Municipality to achieve and maintain an Unassigned General Fund Balance equal to 15% of budgeted expenditures. The Municipality considers a balance of less than 10% to be a cause for concern, barring unusual or deliberate circumstances, and a balance of more than 20% as excessive. An amount in excess of 20% is to be considered for reservation to accumulate funding for purchase of machinery and equipment, for capital projects, and/or to reduce the tax levy requirements, and shall be determined in conjunction with the annual budget process. In the event that the Unassigned General Fund Balance is less than the policy anticipates, the Municipality shall plan to adjust budget resources in the subsequent fiscal years to restore the balance.

Appropriation from Unassigned General Fund Balance shall require the approval of the Municipal Legislature and shall be only for specific disbursements, such as one-time expenditures and capital assets purchases, and not for ongoing expenditures unless a viable plan designated to sustain the expenditures is simultaneously adopted.

**Prioritization of Fund Balance Use**

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

C) Components of Fund Balance

|   | GENERAL FUND         | HEAD START FUND   | ART CENTER FUND     | MULTIPLE USES COLISEUM FUND | DEBT SERVICE FUND    | OTHER GOVERNMENTAL FUNDS | TOTAL GOVERNMENTAL FUNDS |
|---|----------------------|-------------------|---------------------|-----------------------------|----------------------|--------------------------|--------------------------|
| <b>Restricted For:</b>                      |                      |                   |                     |                             |                      |                          |                          |
| Improvement of Streets and Sidewalks        | \$ -                 | \$ -              | \$ -                | \$ -                        | \$ -                 | \$ 267,112               | \$ 267,112               |
| Improvement and Constructions of Facilities | -                    | -                 | 6,200,136           | 8,688,212                   | -                    | 3,896,726                | 18,785,074               |
| Capital Outlay                              | -                    | -                 | -                   | -                           | -                    | 541,559                  | 541,559                  |
| Welfare                                     | 220,850              | -                 | -                   | -                           | -                    | 1,494,383                | 1,715,233                |
| Public Safety                               | 475                  | -                 | -                   | -                           | -                    | 70,645                   | 71,120                   |
| Renewable Energy Projects                   | -                    | -                 | -                   | -                           | -                    | 332,239                  | 332,239                  |
| Improvement to Water and Sewer System       | -                    | -                 | -                   | -                           | -                    | 32,862                   | 32,862                   |
| Debt Repayment                              | -                    | -                 | -                   | -                           | 12,569,029           | -                        | 12,569,029               |
| Public Instruction                          | -                    | 155,919           | -                   | -                           | -                    | 52,592                   | 208,511                  |
| Sanitation                                  | -                    | -                 | -                   | -                           | -                    | 111,139                  | 111,139                  |
| <b>Total Restricted</b>                     | <b>221,325</b>       | <b>155,919</b>    | <b>6,200,136</b>    | <b>8,688,212</b>            | <b>12,569,029</b>    | <b>6,799,257</b>         | <b>34,633,878</b>        |
| <b>Committed To:</b>                        |                      |                   |                     |                             |                      |                          |                          |
| Professional Services                       | 530,161              | -                 | -                   | -                           | -                    | -                        | 530,161                  |
| Solid Waste Disposal                        | 282,858              | -                 | -                   | -                           | -                    | -                        | 282,858                  |
| Welfare                                     | -                    | -                 | -                   | -                           | -                    | 9,024                    | 9,024                    |
| <b>Total Committed</b>                      | <b>813,019</b>       | <b>-</b>          | <b>-</b>            | <b>-</b>                    | <b>-</b>             | <b>9,024</b>             | <b>822,043</b>           |
| <b>Assigned To:</b>                         |                      |                   |                     |                             |                      |                          |                          |
| General Government                          | 241,524              | -                 | -                   | -                           | -                    | 25,533                   | 267,057                  |
| Public Instruction                          | -                    | -                 | -                   | -                           | -                    | 2,091                    | 2,091                    |
| Welfare                                     | 369,981              | -                 | -                   | -                           | -                    | 10,789                   | 380,770                  |
| Improvement and Constructions of Facilities | 108,133              | -                 | -                   | -                           | -                    | 2,944,521                | 3,052,654                |
| Culture and Recreation                      | 11,490               | -                 | -                   | -                           | -                    | 10,444                   | 21,934                   |
| Improvement of Streets and Sidewalks        | 2,489                | -                 | -                   | -                           | -                    | 48,867                   | 51,356                   |
| Capital Outlay                              | 104,853              | -                 | -                   | -                           | -                    | -                        | 104,853                  |
| Public Safety                               | 105,852              | -                 | -                   | -                           | -                    | -                        | 105,852                  |
| <b>Total Assigned</b>                       | <b>944,322</b>       | <b>-</b>          | <b>-</b>            | <b>-</b>                    | <b>-</b>             | <b>3,042,245</b>         | <b>3,986,567</b>         |
| <b>Unassigned:</b>                          |                      |                   |                     |                             |                      |                          |                          |
|   | 12,468,311           | -                 | -                   | -                           | -                    | -                        | 12,468,311               |
| <b>Total Fund Balances</b>                  | <b>\$ 14,446,977</b> | <b>\$ 155,919</b> | <b>\$ 6,200,136</b> | <b>\$ 8,688,212</b>         | <b>\$ 12,569,029</b> | <b>\$ 9,850,526</b>      | <b>\$ 51,910,799</b>     |

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

### D. Interfund Transactions

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

*Interfund Transfers* – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds.

*Intra-Entity Transactions* – Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

### E. Risk Financing

The Municipality carries commercial insurance to cover property and casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Also, principal officials of the Municipality are covered under various surety bonds. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2011 amounted to approximately \$450,981. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$627,302 for workers compensation insurance covering all municipal employees for the same period.

### F. Use of Estimates

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

### G. 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.

### H. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) issued the following pronouncements that have effective dates after June 30, 2011:

*GASB Statement No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans. The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers). The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2011.*

*GASB Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties.*

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

H. Future Adoption of Accounting Pronouncements (continuation)

This Statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting. This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. *The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:*

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

Hereinafter, these pronouncements collectively are referred to as the "FASB and AICPA pronouncements." This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

The Municipality's financial statements were not affected by the implementation of these statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

H. Future Adoption of Accounting Pronouncements (continuation)

*GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, Elements of Financial Statements, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.*

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.

The Municipality has not yet determined the effect this statement will have on the Municipality's financial statements.

*GASB Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53. Some governments have entered into interest rate swap agreements and commodity swap agreements in which a swap counterparty, or the swap counterparty's credit support provider, commits or experience either an act of default or a termination event as both are described in the swap agreement. Many of those governments have replaced their swap counterparty, or swap counterparty's credit support providers, either by amending existing swap agreements or by entering into new swap agreements. When these swap agreements have been reported as hedging instruments, questions have arisen regarding the application of the termination of hedge accounting provisions in Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. Those provisions require a government to cease hedge accounting upon the termination of the hedging derivative instrument, resulting in the immediate recognition of the deferred outflows of resources or deferred inflows of resources as a component of investment income.*

*The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged.*

The Municipality's financial statements were not affected by the implementation of these statements.

3. CASH AND INVESTMENTS

*Cash in Banks*

The Municipality's cash and investments at June 30, 2011 are composed of: (1) demand deposits in commercial banks, (2) demand deposits in the Government Development Bank of Puerto Rico (GDB, fiscal agent), and (3) cash equivalents in commercial banks. Cash equivalents of \$84.3 million are deposits in interest bearing commercial bank accounts and GDB, and are recorded at cost, which approximates fair value.

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

3. CASH AND INVESTMENTS (continuation)

**Cash in Banks (continuation)**

The Municipality follows the practice of pooling cash. At June 30, 2011, the pool cash account in interest bearing commercial banks accounts had a balance of \$56.4 million of which \$29.4 million in the General Fund, \$294,080 of Head Start Program, \$8.9 million in the Art Center Fund, \$7.5 million in the Multiuses Coliseum Fund, and \$10.2 in Other Governmental Funds; of which \$205,396, \$28,178,979, and \$21,055,037 was invested in an interest bearing account in Eurobank, Humacao Branch; Doral Bank, Humacao Branch, and First Bank, Humacao Branch that generates an annual interest rate of 0.80%, 0.38%, and 0.75%, respectively. Also, \$1,765,174 was invested in another account in Popular Bank of Puerto Rico, Trust Division, which generates an annual interest of 0.721%. Other funds are deposit in regular bank accounts. The balance in the pooled cash account is available to meet current operating requirements and any unrestricted excess, if any, is generally invested in interest bearing accounts with commercial banks. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriation.

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

Cash with fiscal agent in the debt service fund consists principally of property tax collections amounting to \$16.4 million that are restricted for the payment of the Municipality's debt service, as required by law. Cash with Fiscal Agent consist principally of \$1.2 million of unspent proceeds of bonds for the Multiuses Coliseum, \$38,650 for the Art Center, \$5,500 in the General Fund, and \$1.7 million in other governmental funds that are restricted for the acquisition, construction or improvement of major capital assets. The amounts deposit in GDB is maintained in interest bearing accounts and is not collateralized.

Municipality follows the provisions of GASB Accounting Standards Codification Section C20, *Cash Deposit with Financial Institutions*, related with cash deposit and interest-earning investment contract with financial institutions. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of the Municipality at June 30, 2011:

**Credit Risk**

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2011, the Municipality has invested only in cash equivalents of \$57.1 million consisting of deposit in interest bearing commercial bank accounts, which are insured by the FDIC, generally up to a maximum of \$250,000. As previously mentioned, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the FDIC coverage. No investments in debt of equity securities were made during the Fiscal Year ended June 30, 2011. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2011.

**Custodial Credit Risk**

This is the risk that, in the event of the failure of a depository financial institution, the Municipality will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Government adopted by GDB, the Municipality may invest in obligations of the Government, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. At June 30, 2011, the Municipality has balances deposited in commercial banks amounting to \$56.4 million which are insured by the FDIC up to the established limit and the excess are fully collateralized as explained above. Deposits in GDB, amounting to \$19.3 million are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2011. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2011, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

3. CASH AND INVESTMENTS (continuation)

**Interest Rate Risk**

This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less, and (3) keeping most of its banks deposits in certificates of deposit and in interest bearing accounts generating interest at prevailing market rates. Therefore, at June 30, 2011, the interest risk associated with the Municipality's cash and cash equivalent is considered low.

**Foreign Exchange Risk**

This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2011.

4. RECEIVABLES

As of June 30, 2011, the amount of \$72,995 corresponds to property taxes for the Debt Service Fund and \$324,507 for the Sales and Usage Taxes.

5. DEFERRED AND UNEARNED REVENUES

Government-wide *Statement of Net Assets* report *deferred* revenues for resources receive before it has a legal claim to them. Governmental funds balance sheet report *deferred revenues* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period (unavailable). Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenues* and *unearned revenues* reported in the basic financial statements were as follows:

|                                 | UNAVAILABLE         | UNEARNED             |
|---------------------------------|---------------------|----------------------|
| Volume of Business Taxes        | \$ -                | \$ 16,531,421        |
| Other Major Funds               | 2,750,560           | -                    |
| Head Start Program              | 4,715,968           | -                    |
| Total Deferred/Unearned Revenue | <u>\$ 7,466,528</u> | <u>\$ 16,531,421</u> |

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS

A. *Interfund Receivable and Payable Balances*

Due to/from Other Funds at June 30, 2011 are summarized as follows:

| INTERFUND RECEIVABLE  | INTERFUND PAYABLE       | AMOUNT              |
|-----------------------|-------------------------|---------------------|
| General Fund          | Head Start Fund         | \$ 253,773          |
| General Fund          | Other Non-Major Funds   | 2,009,133           |
| Other Non-Major Funds | General Fund            | 65,178              |
| Head Start Fund       | Other Non-Major Funds   | 282                 |
| Other Non-Major Funds | Multiuses Coliseum Fund | 10,799              |
| Total                 |                         | <u>\$ 2,339,165</u> |

B. *Interfund Transfers*

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations.

| SOURCES                 | TRANSFER TO             | AMOUNT            | PURPOSE                              |
|-------------------------|-------------------------|-------------------|--------------------------------------|
| General Fund            | Debt Services Fund      | \$ 351,385        | Bond Principal and Interest Payments |
| Other Non-Major Fund    | General Fund            | 198,291           | Equity Transfer                      |
| Multiuses Coliseum Fund | Other Non-Major Fund    | 16,434            | Equity Transfer                      |
| Other Non-Major Fund    | Art Center Fund         | 41,105            | Equity Transfer                      |
| Other Non-Major Fund    | Multiuses Coliseum Fund | 43,513            | Equity Transfer                      |
| General Fund            | Other Non-Major Fund    | 98,214            | Equity Transfer                      |
| Total                   |                         | <u>\$ 748,942</u> |                                      |

7. DUE FROM/TO GOVERNMENTAL UNITS

As of June 30, 2011, balance due from governmental units of the Other Major Fund corresponded to reimbursement of Law 82 (\$7,591) and in the General Fund from Simonet Home (\$401).

The balance due to governmental units of the General Fund for services rendered to the Municipality consists of Water and Sewer Authority (\$28,130), Puerto Rico Treasury Department (\$275,273), AEELA (\$55,521), US Department of Housing and Urban Development (\$21,219) for reimbursement of Section 8 Rental Moderate Rehabilitation Programs, and General Service Administration (\$1,241). Amount due by Art Center Fund is to Infrastructure Financial Agency (\$2,766,843).

8. CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2011 was as follows:

| DESCRIPTION                                   | BALANCE               |                  |                      |             | BALANCE<br>JUNE 30,<br>2011 |
|---|-----------------------|------------------|----------------------|-------------|-----------------------------|
|   | JULY 1,<br>2010       | RECLASSIFICATION | INCREASE             | DECREASE    |                             |
| <b>Non-Depreciable Capital Assets:</b>        |                       |                  |                      |             |                             |
| Land  | \$ 11,702,391         | \$ -             | \$ 161               | \$ -        | \$ 11,702,552               |
| Construction in Progress                      | 55,789,325            | -                | 15,714,049           | -           | 71,503,374                  |
| <b>Total Non-Depreciable Capital Assets</b>   | <b>67,491,716</b>     | <b>-</b>         | <b>15,714,210</b>    | <b>-</b>    | <b>83,205,926</b>           |
| <b>Depreciable Capital Assets:</b>            |                       |                  |                      |             |                             |
| Buildings                                     | 54,960,191            | -                | 200,000              | -           | 55,160,191                  |
| Infrastructure                                | 23,111,300            | -                | -                    | -           | 23,111,300                  |
| Motor Vehicles                                | 8,412,270             | -                | 632,527              | -           | 9,044,797                   |
| Equipment                                     | 6,045,182             | 114,533          | 353,665              | -           | 6,513,380                   |
| Capital Lease                                 | 114,533               | (114,533)        | -                    | -           | -                           |
| <b>Total Depreciable Capital Assets</b>       | <b>92,643,476</b>     | <b>-</b>         | <b>1,186,192</b>     | <b>-</b>    | <b>93,829,668</b>           |
| <b>Less Accumulated Depreciation:</b>         |                       |                  |                      |             |                             |
| Buildings                                     | (17,477,525)          | -                | (1,062,407)          | -           | (18,539,932)                |
| Infrastructure                                | (5,579,074)           | -                | (359,487)            | -           | (5,938,561)                 |
| Motor Vehicles                                | (6,548,545)           | -                | (406,592)            | -           | (6,955,137)                 |
| Equipment                                     | (4,370,389)           | (91,626)         | (705,191)            | -           | (5,167,206)                 |
| Capital Lease                                 | (91,626)              | 91,626           | -                    | -           | -                           |
| <b>Total Accumulated Depreciation</b>         | <b>(34,067,159)</b>   | <b>-</b>         | <b>(2,533,677)</b>   | <b>-</b>    | <b>(36,600,836)</b>         |
| <b>Total Depreciable Capital Assets (Net)</b> | <b>58,576,317</b>     | <b>-</b>         | <b>(1,347,485)</b>   | <b>-</b>    | <b>57,228,832</b>           |
| <b>CAPITAL ASSETS, NET</b>                    | <b>\$ 126,068,033</b> | <b>\$ -</b>      | <b>\$ 14,366,725</b> | <b>\$ -</b> | <b>\$ 140,434,758</b>       |

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

|                                    | AMOUNT              |
|------------------------------------|---------------------|
| Mayor and Municipal Legislature    | \$ 354,715          |
| General Government                 | 228,031             |
| Public Safety                      | 202,694             |
| Public Works                       | 785,440             |
| Culture and Recreation             | 734,766             |
| Human Service and Welfare          | 126,684             |
| Urban Development                  | 101,347             |
| <b>Total Depreciation Expenses</b> | <b>\$ 2,533,677</b> |

9. GENERAL LONG-TERM DEBTS

A. General and Special Obligations Bonds

The principal long-term obligations of the Municipality are general obligation bonds and special obligation bonds issued to finance the construction and improvements of public facilities and purchase of machinery and equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 10). The following is a summary of general and special obligation bonds of the Municipality as of June 30, 2011:

| Type of Obligation and Purpose                          | Maturity Date | Interest Rate | Amount               |
|---|---------------|---------------|----------------------|
| <b>General Obligation Bonds - Property Taxes</b>        |               |               |                      |
| \$5,200,000, Series 2003-04 - General Construction      | 2028          | 5.00%         | \$ 4,445,000         |
| \$4,020,000, Series 2002-03 - General Construction      | 2027          | 5.00%         | 3,330,000            |
| \$1,099,000, Series 1995 - Purchase of Equipment        | 2013          | 5.45%         | 305,000              |
| \$1,485,000, Series 1995 - General Construction         | 2014          | 5.17%         | 560,000              |
| \$8,395,000, Series 1998 - General Construction         | 2018          | 6.46%         | 4,820,000            |
| \$1,720,000, Series 2005 - General Construction         | 2030          | 5.02%         | 1,535,000            |
| \$370,000, Series 2006 - Land Acquisition               | 2030          | 5.02%         | 325,000              |
| \$10,620,000, Series 2006 - General Construction        | 2031          | *1            | 9,725,000            |
| \$10,620,000, Series 2006 - General Construction        | 2031          | *1            | 9,720,000            |
| \$2,055,000, Series 2007 - Purchase of Equipment        | 2014          | 7.50%         | 1,300,000            |
| \$19,915,000, Series 2010 - General Construction        | 2035          | *2            | 19,915,000           |
| <b>Total General Obligations Bonds</b>                  |               |               | <b>55,980,000</b>    |
| <b>Special Obligations Bonds - Property Taxes</b>       |               |               |                      |
| \$4,786,000, Series 1995 - Refinancing Purpose          | 2013          | 7.81%         | 1,320,000            |
| \$1,412,000, Rural Development - General Construction   | 2030          | 4.25%         | 1,326,000            |
| \$848,000, Rural Development - General Construction     | *3            | *3            | 848,000              |
| \$2,900,000, Rural Development - General Construction   | *3            | *3            | 1,837,785            |
| <b>Total Special Obligations Bonds - Property Taxes</b> |               |               | <b>5,331,785</b>     |
| <b>Special Obligation Bonds - Sales and Usage Taxes</b> |               |               |                      |
| \$10,040,000, Series 2008 - General Construction        | 2016          | 7.50%         | 9,735,000            |
| <b>Total Special Obligations Bonds</b>                  |               |               | <b>15,066,785</b>    |
| <b>Total General and Special Obligation Bonds</b>       |               |               | <b>\$ 71,046,785</b> |

\*1 - Interest on these bonds are set at the payments date using the London Interbank Offered Rate (LIBOR) - 90 days, plus 0.19%.

\*2 - Interest on these bonds are set at the payments date using the prevailing Prime Rate plus 1.55%.

\*3 - These terms will be determined by the loan grantor upon completion of the construction activities.

According to Sections 103 and 148 through 150 of the US Internal Revenue Code and Sections 1.148 through 1.150 of the US Treasury Regulation, the Municipality's tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2011, the Municipality had no federal arbitrage liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

9. GENERAL LONG-TERM DEBTS (continuation)

**B. Legal Debt Limit and Legal Debt Margin**

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

**C. Other Long-Term Debts**

**Borrowing from MRCC**

On July 1, 2007, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 146. The original debt was \$730,449 to be paid during 25 years plus annual interest of 6.22%.

On November 28, 2001, the Municipality entered into a repayment agreement with the GDB and MRCC to pay for the proportional debt to cover the Land Information Management System (LIMS), system established by MRCC with the capacity to maintaining cadastre and photos of all real property of Puerto Rico. The original debt was \$1,833,035 to be paid during 10 years plus annual interest of 5.95%.

On July 1, 2002, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 42. The original debt was \$492,779 to be paid during 30 years plus annual interest of 6.1875%.

**Claims and Judgment**

This amount represents the amount accrued for possible claims arising from litigations.

**Compensated Absences**

This amount represents the estimated accrued vacation benefits, accrued sick leave benefits and payroll related benefits, representing the Municipality's commitment to fund such costs from future operations.

Following are the Other Long-Term Debts:

| DESCRIPTION          | BALANCE             | NEW               | RETIREMENTS           | BALANCE             | AMOUNTS                | AMOUNTS                |
|----------------------|---------------------|-------------------|-----------------------|---------------------|------------------------|------------------------|
|                      | JULY 1,<br>2010     |                   | AND                   | JUNE 30,<br>2011    | DUE WITHIN<br>ONE YEAR | DUE AFTER<br>NEXT YEAR |
| Property Taxes-MRCC  | \$ 730,827          |                   | \$ (730,827)          | \$ -                | \$ -                   | \$ -                   |
| Law Number 146-MRCC  | 642,795             | -                 | (29,218)              | 613,577             | 29,218                 | 584,359                |
| LIMS Debt-MRCC       | 347,872             | -                 | (228,499)             | 119,373             | 119,373                | -                      |
| Law Number 42-MRCC   | 438,107             | -                 | (9,364)               | 428,743             | 9,952                  | 418,791                |
| Claims and Judgments | -                   | 162,000           | -                     | 162,000             | -                      | 162,000                |
| Compensated Absences | 5,726,883           | 343,039           | (570,753)             | 5,499,169           | 3,620,966              | 1,878,203              |
| <b>TOTAL</b>         | <b>\$ 7,886,484</b> | <b>\$ 505,039</b> | <b>\$ (1,568,661)</b> | <b>\$ 6,822,862</b> | <b>\$ 3,779,509</b>    | <b>\$ 3,043,353</b>    |

9. GENERAL LONG-TERM DEBTS (continuation)

D. Changes in General Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2011:

| DESCRIPTION         | BALANCE              | NEW<br>ISSUE        | RETIREMENTS           | BALANCE              | AMOUNTS                | AMOUNTS                |
|---------------------|----------------------|---------------------|-----------------------|----------------------|------------------------|------------------------|
|                     | JULY 1,<br>2010      |                     | AND<br>ADJUSTMENTS    | JUNE 30,<br>2011     | DUE WITHIN<br>ONE YEAR | DUE AFTER<br>NEXT YEAR |
| General Obligations | \$ 57,640,000        | \$ -                | \$ (1,660,000)        | \$ 55,980,000        | \$ 2,170,000           | \$ 53,810,000          |
| Special Obligations | 14,508,289           | 2,012,496           | (1,454,000)           | 15,066,785           | 622,000                | 14,444,785             |
| Capital Lease       | 14,241               | -                   | (14,241)              | -                    | -                      | -                      |
| Other Debts         | 7,886,484            | 505,039             | (1,568,660)           | 6,822,863            | 3,779,509              | 3,043,354              |
| <b>TOTAL</b>        | <b>\$ 80,049,014</b> | <b>\$ 2,517,535</b> | <b>\$ (4,696,901)</b> | <b>\$ 77,869,648</b> | <b>\$ 6,571,509</b>    | <b>\$ 71,298,139</b>   |

E. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The Municipality believes it is in compliance with all significant limitations and restrictions.

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2011 are as follows:

| YEAR ENDING<br>JUNE 30, | General Obligation Bonds |                      | Special Obligation Bonds |                      | Other Long-Term Obligations |                     | TOTAL                |                      |
|-------------------------|--------------------------|----------------------|--------------------------|----------------------|-----------------------------|---------------------|----------------------|----------------------|
|                         | PRINCIPAL<br>PAYMENT     | INTEREST<br>PAYMENT  | PRINCIPAL<br>PAYMENT     | INTEREST<br>PAYMENT  | PRINCIPAL<br>PAYMENT        | INTEREST<br>PAYMENT | PRINCIPAL            | INTEREST             |
| 2012                    | \$ 2,170,000             | \$ 2,518,263         | \$ 622,000               | \$ 543,587           | \$ 3,779,509                | \$ 68,094           | \$ 6,571,509         | \$ 3,129,944         |
| 2013                    | 2,310,000                | 3,319,671            | 674,000                  | 820,394              | 2,079,999                   | 62,099              | 5,063,999            | 4,202,164            |
| 2014                    | 2,465,000                | 3,180,059            | 721,000                  | 767,462              | 40,461                      | 59,617              | 3,226,461            | 4,007,138            |
| 2015                    | 2,505,000                | 3,033,940            | 263,000                  | 731,107              | 41,166                      | 57,092              | 2,809,166            | 3,822,139            |
| 2016                    | 2,115,000                | 2,898,563            | 285,000                  | 712,355              | 41,918                      | 54,526              | 2,441,918            | 3,665,444            |
| 2016-2020               | 11,090,000               | 12,288,490           | 1,738,000                | 3,229,412            | 222,609                     | 232,343             | 13,050,609           | 15,750,245           |
| 2021-2025               | 11,800,000               | 9,242,584            | 2,426,000                | 2,634,250            | 249,865                     | 159,653             | 14,475,865           | 12,036,487           |
| 2026-2030               | 13,670,000               | 5,213,969            | 3,307,000                | 1,501,562            | 286,829                     | 77,255              | 17,263,829           | 6,792,786            |
| 2031-2035               | 7,855,000                | 1,456,125            | 2,345,000                | -                    | 80,507                      | 5,024               | 10,280,507           | 1,461,149            |
| Unmatured               | -                        | -                    | 2,685,785                | -                    | -                           | -                   | 2,685,785            | -                    |
| <b>TOTAL</b>            | <b>\$ 55,980,000</b>     | <b>\$ 43,151,664</b> | <b>\$ 15,066,785</b>     | <b>\$ 10,940,129</b> | <b>\$ 6,822,863</b>         | <b>\$ 775,703</b>   | <b>\$ 77,869,648</b> | <b>\$ 54,867,496</b> |

10. DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality (See Note 11).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 9). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

## 11. PROPERTY TAXES

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1<sup>st</sup> of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business, or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market price).

The MRCC is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding tax contribution.

The personal property tax is self-assessed by the taxpayer on a return, which is to be filed and paid in full by May 15 of each year with the MRCC and based on current values as of December 31 of previous year. Real property tax is assessed by the MRCC on each piece of real estate and on each building or residence. The property tax contribution is levied each year over the appraised value of the real property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957.

The MRCC is responsible for the billing of real property taxes and collections of both, personal and real property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the MRCC informs the Municipality of the estimated amount of property taxes expected to be collected for the ensuing fiscal year. Throughout the year, the MRCC advances funds to the Municipality based on the initial estimated collections. The MRCC is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the MRCC remits to the Municipality property taxes advances, which are less than the tax actually collected, a receivable from the MRCC is recorded at June 30. However, if advances exceed the amount actually collected, a borrowing from MRCC is recorded at June 30. The difference between the advances and the final settlement from MRCC for the fiscal year 2011 resulted in a receivable of \$72,995 for the Debt Service Fund. At the time of the preparation of the financial statement, the difference between the advances and the final settlement to the General Fund is pending of final determination.

The tax rate for fiscal year 2011 is 8.83% for real property and 6.83% for personal property of which 1.03% of both are for the redemption of public debt issued by the Commonwealth of Puerto Rico and 7.80% and 5.80%, respectively, belongs to the Municipality. The Commonwealth of Puerto Rico also contributes an annual tax rate of 0.20% of the property tax collected. The remaining percentage is distributed as follows: (a) 6.00% and 4.00%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The remaining portion belonging to the Municipality of 1.80% represents the ad-valorem property taxes withheld by the MRCC and restricted for debt service, which is accounted for through the debt service fund (See Note 12). The Municipality hasn't reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

As previously mentioned, on March 9, 2009, the Commonwealth of Puerto Rico approves Law Number 7 that provides for revision of the valuation of property subject to taxation and imposes special property taxes for the Commonwealth. The effect of this Law was an increase in the valuation of the real properties and in the exemption granted for the residential units occupied by their owners by multiply both amount by ten. Accordingly, the residential units occupied by their owners are exempt from real property taxes on the first \$150,000 assessed value. For such exempted amounts, the Puerto Rico Secretary of the Treasury assumes payment of the basic tax to the Municipality (6.00%), except for residential units assessed at less than \$35,000 on which a complete exemption is granted. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Secretary of the Treasury to the Municipality was frozen as of January 1, 1992. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

In addition, the law grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with an annual net sales volume of less than \$150,000. The MRCC advances to the Municipality, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the MRCC from taxpayers. The MRCC periodically informs to the Municipality the amounts collected from taxpayers and applied to outstanding advances.

#### 11. PROPERTY TAXES (continuation)

The Municipality records as revenue in the general fund the property tax contribution when received from monthly advances from MRCC. Due to the fact that collections of property tax are applied to the advances of property tax paid by the MRCC, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

#### 12. VOLUME OF BUSINESS TAXES

The volume of business taxes is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due five working days after April 15 of each year. Entities with sales volume of \$3.0 million or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2011, the tax rates were as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.50% for all other organizations.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration on or before the due date, the taxpayer is granted a 5% of discount. The volume of business tax receivable represents filed tax returns that were uncollected as of June 30, 2011. Collections of taxes during current fiscal year corresponding of the tax return based on the prior year gross sales are applicable to the next fiscal year and recorded as deferred revenues in the General Fund.

#### 13. SALES AND USAGE TAXES

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

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

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

Sales tax receivable represents filed sales tax returns that were collected subsequent to June 30, 2011, but pertaining to the current year period.

As per Ordinance Number 1, Series 2007-2008, the Municipality authorized that one third (1/3) of the sales taxes collected should be appropriated for the investment of Eligible Activities and Infrastructure Fund created by Ordinance Number 44, Series 2006-2007.

#### 14. CONSTRUCTION EXCISE TAXES

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

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

- a. All construction of a single-family residential construction projects not related to housing development projects, condominiums, or any similar projects, with a total cost exceeding \$50,000, will pay 5% of construction excise taxes. This project is exempt of the construction excise taxes for the first \$50,000 of the project construction costs.
- b. All construction projects related to improvement to a single-family residential using as principal residence are exempt of the construction excise taxes for the first \$10,000 of the project construction costs. The swimming pool is not considered and improvement to a single-family residential, accordingly, is not exempt of the construction excise taxes.
- c. All construction projects carried out by philosophic and humanistic organization have full exemption to the construction excise taxes.
- d. All construction projects carried out by state, federal and municipal governments have full exemption to the construction excise taxes if such projects are performed by administration.
- e. All commercial projects in Urban Center of the Municipality should paid 1.5% of construction excise taxes. All residential projects in Urban Center have full exemption, including second plant to existing residential or commercial buildings to be used as social interest residential.

#### 15. INTERGOVERNMENTAL REVENUES

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

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

#### 16. PENSION PLAN

##### *Description of the Plan*

Employees of the Municipality participate in the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). The ERS is cost-sharing multiple-employer defined benefit pension plan sponsored by the Government under the Act No. 447, approved on May 15, 1951, as amended. ERS covers all regular employees of the Government and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

16. PENSION PLAN (continuation)

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service or members who have attained at least 58 years of age and have completed at least 10 years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average salary, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average salary, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive up to a maximum of 65% of the average salary, as defined, or if they have attained 55 years of age will receive up to a maximum of 75% of the average salary, as defined. Disability retirement benefits are available to members for occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable services.

The contribution requirements for both employees and employers are established by law and are not actuarially determined. Employees are required to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of their monthly gross salary. The Municipality is required by Act No. 447 to contribute 9.275% of its employees' gross salaries.

Act No. 1 of 1990 made certain amendments applicable to new participants joining the ERS effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275% of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5% of the average salary, as defined, for all years of creditable services, a decrease in the maximum disability, and death benefits annuities from 50% to 40% of average salary, as defined, and the elimination of the Merit Annuity for participants who have completed 30 years of creditable services.

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) 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 System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan there will be a pool of pension assets, which will be invested by the System, together with those of the current defined-benefit plan. Benefits at retirement age will not be guaranteed by the Government. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (9.275% of the employees' salary) will be used to fund the current plan.

If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

**Funding Policy**

The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state of municipal contributions), are established or may be amended by law.

Contribution requirements are established by law and are as follows:

|                                   |                                      |
|-----------------------------------|--------------------------------------|
| Municipality                      | 9.275% of gross salary               |
| Employees:                        |                                      |
| Hired on or before March 31, 1990 | 5.775% of gross salary up to \$6,600 |
|                                   | 8.275% of gross salary over \$6,600  |
| Hired on or after April 1, 1990   | 8.275% of gross salary               |

16. PENSION PLAN (continuation)

**Annual Contribution**

Total employee contributions to the above-mentioned plans during the year ended June 30, 2011, 2010 and 2009 amounted to approximately \$3,177,014. The Municipality's contributions during those years are recognized as total pension expenditures/expenses in the category of administration as follow:

| FISCAL YEAR | LAW NO. 447 | SYSTEM 2000 |
|-------------|-------------|-------------|
| 2011        | \$ 515,047  | \$ 522,773  |
| 2010        | 557,540     | 496,522     |
| 2009        | 606,470     | 478,662     |

These amounts represented the 100% of the required contribution for the corresponding year. Additionally, changes made in the types and amounts of benefits offered by special laws and costs of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

The Employee's Retirement System of the Government of Puerto Rico provides additional information of the ERS and System 2000. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Government. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

17. CONTINGENCIES

**A. Claims and Judgments**

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

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available cannot determine the final outcome of these claims. Accordingly, the financial statements do not include adjustment, if any, that could result from the resolution of this legal proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claimed amounts.

**B. Federal Grants**

In the normal course of operations, the Municipality receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. The expenditures financed by grants are subject to program compliance audits by the grantor and passed-through agencies in order to assure compliance with grant requirements. If expenditures are disallowed due to noncompliance with grant program requirements, the Municipality may be required to reimburse the grantor or pass-through agencies. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

**18. COMMITMENTS**

**A. Operating Leases**

The Municipality leases real property, buildings, and equipment under various operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same term. Rental expenditures/expenses recorded in the general fund and in other governmental funds for the year ended June 30, 2011, amounted to approximately \$305,988. Management believes that the summary of the future minimum rental commitments under noncancelable real property and equipment lease with terms exceeding one year is not material to the basic financial statements taken as a whole.

**B. Construction and Improvement Commitments**

The Municipality had encumbrances at June 30, 2011 for the construction, improvements, or renovation of several municipal facilities in the following funds:

|                         | <u>Encumbered For</u>                      | <u>Amount</u> | <u>Reported within Fund Balance Classification</u>       |
|-------------------------|--|---------------|--|
| General Fund            | Solid Waste Disposal                       | \$ 282,858    | Committed to Waste Disposal                              |
| Multiuses Coliseum Fund | Construction of Multiuses Coliseum         | 4,529,900     | Restricted to Improvement and Construction of Facilities |
| Non Major Funds         | Improvement and Construction of Facilities | 578,049       | Restricted to Improvement and Construction of Facilities |

**19. NET ASSETS/FUND BALANCES RESTATEMENTS**

**A. Net Assets Restatements**

During the year, the Municipality adjusted the governmental net assets for capital assets not previously recognized and for unrecognized revenues. The following schedule reconciles the June 30, 2010 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2010, for Governmental Activities.

|  | <b>NET ASSETS</b>    |
|--|----------------------|
| Net Assets, as Previously Reported,<br>June 30, 2010 | \$123,955,500        |
| Proceed of Bonds not recognized                      | (673,289)            |
| Adjustments to fund balances                         | <u>(243,163)</u>     |
| Beginning Net Assets, as Restated,<br>July 1, 2010   | <u>\$123,039,048</u> |

19. NET ASSETS/FUND BALANCES RESTATEMENTS (continuation)

B. Fund Balances Restatements

The following reconciles the June 30, 2010 Fund Balance, as previously reported to Beginning Fund Balance, as restated, July 1, 2010 for the following funds:

|  | GENERAL<br>FUND      | HEAD<br>START<br>FUND | ART<br>CENTER<br>FUND | MULTIUSES<br>COLISEUM<br>FUND | DEBT<br>SERVICE<br>FUND | OTHER<br>GOVERNMENTAL<br>FUNDS | TOTAL<br>GOVERNMENTAL<br>FUNDS |
|--|----------------------|-----------------------|-----------------------|-------------------------------|-------------------------|--------------------------------|--------------------------------|
| Fund Balance, as Previously Reported,<br>June 30, 2010 | \$ 9,114,169         | \$ 433,072            | \$ 10,540,290         | \$ 19,538,396                 | \$ 10,773,759           | \$ 10,894,723                  | \$ 61,294,409                  |
| Reclassified Fund Balance to implement GASB 54         | 1,247,538            | -                     | -                     | -                             | -                       | (1,247,538)                    | -                              |
| Adjustment to principal expenditures                   | -                    | -                     | -                     | -                             | 1,685,000               | -                              | 1,685,000                      |
| Cancellation of prior year accounts receivable         | -                    | -                     | -                     | -                             | (590,369)               | -                              | (590,369)                      |
| Cancellation of prior year accounts payable            | 140,001              | -                     | -                     | -                             | -                       | 90,748                         | 230,749                        |
| Cancellation of prior year due to agency               | -                    | -                     | -                     | -                             | -                       | 66,009                         | 66,009                         |
| Adjustment to fund balance not recognized              | -                    | -                     | -                     | -                             | -                       | 50,448                         | 50,448                         |
| Beginning Fund Balance, as Restated,<br>July 1, 2010   | <u>\$ 10,501,708</u> | <u>\$ 433,072</u>     | <u>\$ 10,540,290</u>  | <u>\$ 19,538,396</u>          | <u>\$ 11,868,390</u>    | <u>\$ 9,854,390</u>            | <u>\$ 62,736,246</u>           |

END OF NOTES

MUNICIPALITY OF HUMACAO, PUERTO RICO

**REQUIRED SUPPLEMENTARY INFORMATION**

YEAR ENDED JUNE 30, 2011

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO  
REQUIRED SUPPLEMENTARY INFORMATION  
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

|  | Budget Amounts      |                     | Actual Amounts                           | Variance with       |
|--|---------------------|---------------------|--|---------------------|
|  | Original            | Final               | (Budgetary Basis)<br>(See Notes 1 and 2) | Final Budget        |
| <b>BUDGETARY FUND BALANCE,<br/>AS RESTATED, JULY 1, 2010</b> | <b>\$ 7,637,608</b> | <b>\$ 7,637,608</b> | <b>\$ 7,637,608</b>                      | <b>\$ -</b>         |
| Resources (Inflows):   |                     |                     |  |                     |
| Property Taxes   | 12,887,654          | 12,887,654          | 12,805,232                               | (82,422)            |
| Volume of Business Taxes                                     | 15,571,000          | 15,571,000          | 17,833,289                               | 2,262,289           |
| Sales and Usage Taxes  | 4,000,000           | 4,000,000           | 4,227,498                                | 227,498             |
| Intergovernmental Revenues                                   | 4,975,226           | 4,975,226           | 5,251,690                                | 276,464             |
| Construction Excise Taxes                                    | 2,125,000           | 2,125,000           | 2,708,153                                | 583,153             |
| Interest   | 1,100,000           | 1,100,000           | 773,439                                  | (326,561)           |
| Miscellaneous  | 1,225,000           | 1,225,000           | 1,280,953                                | 55,953              |
| Total Resources (Inflows)                                    | 41,883,880          | 41,883,880          | 44,880,254                               | 2,996,374           |
| Amounts Available for Appropriation                          | 49,521,488          | 49,521,488          | 52,517,862                               | 2,996,374           |
| Charges to Appropriations (Outflows):                        |                     |                     |  |                     |
| Mayor and Municipal Legislature                              | 3,134,689           | 3,440,251           | 3,135,424                                | 304,827             |
| General Government   | 16,142,194          | 16,403,556          | 16,972,311                               | (568,755)           |
| Public Safety  | 3,670,559           | 3,602,752           | 3,113,413                                | 489,339             |
| Public Works   | 4,140,685           | 4,052,525           | 3,830,440                                | 222,085             |
| Culture and Recreation                                       | 2,417,563           | 2,435,817           | 1,927,144                                | 508,673             |
| Health and Sanitation  | 1,715,105           | 1,715,105           | 1,715,105                                | -                   |
| Solid Waste Disposal   | 3,240,000           | 3,294,000           | 3,284,949                                | 9,051               |
| Human Services and Welfare                                   | 5,795,476           | 5,746,699           | 5,413,567                                | 333,132             |
| Urban Development  | 1,319,244           | 1,247,891           | 1,043,466                                | 204,425             |
| Capital Outlays  | 308,365             | 308,365             | 250,706                                  | 57,659              |
| Transfers to Other Funds                                     | -                   | 449,599             | 449,599                                  | -                   |
| Total Charges to Appropriations                              | 41,883,880          | 42,696,560          | 41,136,124                               | 1,560,436           |
| <b>BUDGETARY FUND BALANCE, JUNE 30, 2011</b>                 | <b>\$ 7,637,608</b> | <b>\$ 6,824,928</b> | <b>\$ 11,381,738</b>                     | <b>\$ 4,556,810</b> |

See accompanying Notes to Required Supplementary Information

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO  
**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**  
**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

**1. Budgetary Reporting**

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

**2. Explanation of Differences Between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures**

|  | <u>General Fund</u>  |
|--|----------------------|
| <b>Sources/Inflows of Resources:</b>   |                      |
| Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 54)                            | \$ 52,517,862        |
| Difference – Budget to GAAP:   |                      |
| The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes           | <u>(7,637,608)</u>   |
| Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 21)             | <u>\$ 44,880,254</u> |
| <b>Uses/Outflows of Resources:</b>   |                      |
| Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 54)                         | \$ 41,136,124        |
| Difference – Budget to GAAP:   |                      |
| Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes | (1,004,025)          |
| Payment of Prior Year Encumbrance  | 570,743              |
| Reclassified Expenditures per GASB Number 54   | 430,434              |
| Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes                         | <u>(449,599)</u>     |
| Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 21)         | <u>\$ 40,683,677</u> |

**3. Explanation of Differences Between Budgetary Fund Balance and GAAP Fund Balance**

|  |                      |
|--|----------------------|
| Budgetary Fund Balance, June 30, 2011    | \$ 11,381,738        |
| Timing Differences:                      |                      |
| Encumbrances                             | 1,004,025            |
| Cancellation of Prior Years Encumbrances | 369,051              |
| Payments of Prior Year Encumbrances      | (570,743)            |
| Perspective Differences:                 |                      |
| Due from Other Funds not Available       | <u>2,262,906</u>     |
| Total Fund Balance, June 30, 2011        | <u>\$ 14,446,977</u> |

**END OF THIS SECTION**

**MUNICIPALITY OF HUMACAO, PUERTO RICO**

**SINGLE AUDIT SECTION**

**YEAR ENDED JUNE 30, 2011**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

| FEDERAL GRANTOR / PASS THROUGH<br>GRANTOR / PROGRAM OR CLUSTER TITLE                              | CFDA<br>NUMBER | FEDERAL<br>ENTITY IDENTIFYING<br>NUMBER | PASS-THROUGH<br>FEDERAL<br>EXPENDITURES |
|---|----------------|---|---|
| U.S. Department of Agriculture:   |                |   |   |
| Pass-Through Puerto Rico Department of Education:   |                |   |   |
| Child and Adult Care Food Program .....   | 10.558         | CC-081                                  | \$ 929,739                              |
| Pass-Through USDA – Rural Development:  |                |   |   |
| Water and Waste Disposal System for Rural Communities .....                                       | 10.760         | 63-003-690-66-0046                      | <u>2,390,347</u>                        |
| Total U.S. Department of Agriculture .....  |                |   | <u>3,320,086</u>                        |
| U.S. Department of Housing and Urban Development:   |                |   |   |
| Community Development Block Grant/Entitlement   |                |   |   |
| Grants (CDBG) (Cluster) .....   | 14.218         |   | 1,844,657                               |
| <b>ARRA</b> – Community Development Block Grant/Entitlement<br>Grants (CDBG) (Cluster) .....      | 14.253         |   | <u>44,149</u>                           |
| Subtotal Community Development Block Grant/Entitlement<br>Grants (CDBG) (Cluster) .....           |                |   | 1,888,806                               |
| Emergency Shelter Grants Program (ESG) .....  | 14.231         |   | 26,600                                  |
| Housing Opportunities for Persons with AIDS (HOPWA) .....   | 14.241         |   | 61,950                                  |
| <b>ARRA</b> – Homelessness Prevention and Rapid Re-Housing<br>Program (HPRP) .....                | 14.257         |   | 340,476                                 |
| Section 8 Housing Choice Vouchers .....   | 14.871         |   | <u>2,116,329</u>                        |
| Total U.S. Department of Housing and Urban Development ....                                       |                |   | <u>4,434,161</u>                        |
| U.S. Department of Justice:   |                |   |   |
| Pass-Through Puerto Rico Department of Justice:   |                |   |   |
| <b>ARRA</b> – Edward Byrne Memorial Assistance Grant Program ....                                 | 16,738         | 2009-SU-B9-0053                         | <u>130,625</u>                          |
| U.S. Department of Transportation:  |                |   |   |
| Federal Transit – Capital Investment Grants (Cluster) .....                                       | 20.500         |   | 403,888                                 |
| <b>ARRA</b> – Federal Transit – Formula Grants (Urbanized Area<br>Formula Program (Cluster) ..... | 20.507         |   | <u>131,792</u>                          |
| Subtotal Federal Transit Program (Cluster) .....  |                |   | 535,680                                 |
| Pass-Through Traffic Safety Commission:   |                |   |   |
| State Traffic Safety Information System Improvements Grants ..                                    | 20.610         | 11-06-18                                | <u>19,142</u>                           |
| Total U.S Department of Transportation .....  |                |   | <u>554,822</u>                          |
| U.S. Department of Energy:  |                |   |   |
| <b>ARRA</b> – Energy Efficiency and Conservation Grant Program .....                              | 81.128         |   | <u>18,200</u>                           |
| Subtotal Expenditures of Federal<br>Awards (Balance Carry Forward) .....                          |                |   | <u>8,457,894</u>                        |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

| FEDERAL GRANTOR / PASS THROUGH<br>GRANTOR / PROGRAM OR CLUSTER TITLE               | FEDERAL<br>CFDA<br>NUMBER | PASS-THROUGH<br>ENTITY IDENTIFYING<br>NUMBER | FEDERAL<br>EXPENDITURES    |
|--|---------------------------|--|----------------------------|
| Subtotal of Expenditures of Federal Awards<br>(Balance Brought Forward) .....      |                           |  | <u>\$ 8,457,894</u>        |
| U. S. Department of Health and Human Services:                                     |                           |  |                            |
| Pass-Through Elderly Office:   |                           |  |                            |
| Special Programs for the Aging – Title III, Part C –<br>Nutritional Services ..... | 93.045                    | 100253R2                                     | <u>42,354</u>              |
| Pass-Through Administration for the Childhood Care and<br>Integral Development:    |                           |  |                            |
| Child Care and Development Block Grant (Cluster) .....                             | 93.575                    | 3011-039                                     | 287,184                    |
| <b>ARRA</b> – Child Care and Development Block Grant (Cluster) .....               | 93.713                    | 2009-2010                                    | <u>9,020</u>               |
| Subtotal Child Care and Development Block Grant (Cluster) .....                    |                           |  | <u>296,204</u>             |
| Head Start Program (Cluster) .....   | 93.600                    | 02CH0483-006<br>02CH9944-006                 | 5,971,367<br>1,289,658     |
| <b>ARRA</b> – Head Start Program (Cluster) .....                                   | 93.708                    | 241-2010-000134                              | 205,569                    |
| Early Head Start (Cluster) .....   | 93.600                    | 02CH9909/09<br>02CH9909/10                   | 1,318,582<br>76,889        |
| <b>ARRA</b> – Early Head Start Program (Cluster) .....                             | 93.709                    | 02SE9909/10                                  | <u>10,316</u>              |
| Subtotal Head Start Program (Cluster) .....  |                           |  | <u>8,872,381</u>           |
| Total U.S. Department of Health and Human Services .....                           |                           |  | <u>9,210,939</u>           |
| U.S. Department of Homeland Security:  |                           |  |                            |
| Pass-Through Office of the Governor Authorized<br>Representative:                  |                           |  |                            |
| Disaster Grants – Public Assistance (Presidentially Declared<br>Disasters) .....   | 97.036                    | FEMA-1798                                    | 33,874                     |
| Homeland Security Grant Program (HSGP) .....                                       | 97.067                    | 2007-GE-T7-0043                              | <u>137</u>                 |
| Total U.S. Department of Homeland Security .....                                   |                           |  | <u>34,011</u>              |
| <b>TOTAL EXPENDITURES OF FEDERAL AWARDS .....</b>                                  |                           |  | <b><u>\$17,702,844</u></b> |

See accompanying Notes to Schedule of Expenditures of Federal Awards.

**1. BASIS OF PRESENTATION**

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

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

**3. FEDERAL CFDA NUMBER**

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

**4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Expenditures of federal awards are reported in the Municipality's Statement of Revenues, Expenditures and Changes in Fund Balances- Governmental Fund as follows: Head Start - \$7,466,594 and Other Governmental Funds \$10,236,250.

**5. SUBRECIPIENTS**

Of the federal expenditures presented in the Schedule, the Municipality provided federal awards to subrecipients as follows:

| PROGRAM TITLE   | FEDERAL<br>CFDA<br>NUMBER | AMOUNT<br>PROVIDED<br>TO SUBRECIPIENTS |
|---|---------------------------|--|
| ARRA Homelessness Prevention And Rapid Re-Housing<br>Program (HPRP) ..... | 14.257                    | <u>\$99,479</u>                        |

**6. MAJOR PROGRAMS**

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

**END OF NOTES**

**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**

Honorable Mayor and Member of the  
Municipal Assembly  
Municipality of Humacao, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of Humacao, Puerto Rico, as of and for the year ended June 30, 2011, which collectively comprise the Municipality of Humacao, Puerto Rico's basic financial statements and have issued our report thereon dated March 26, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

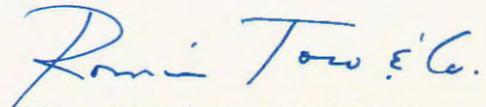
**Compliance and Other Matters**

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

**Compliance and Other Matters, (continued)**

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

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



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Yauco, Puerto Rico  
March 26, 2012

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

Honorable Mayor and Member of the  
Municipal Assembly  
Municipality of Humacao, Puerto Rico

**Compliance**

We have audited Municipality of Humacao, Puerto Rico's compliance, with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Municipality of Humacao, Puerto Rico's major federal programs for the year ended June 30, 2011. Municipality of Humacao, Puerto Rico's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality of Humacao, Puerto Rico's management. Our responsibility is to express an opinion on Municipality of Humacao, Puerto Rico's compliance based on our audit.

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

In our opinion, Municipality of Humacao, Puerto Rico, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. However, the results of our auditing procedures disclosed instances of non-compliance with those requirements, 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 item 2011-III-1.

**Internal Control Over Compliance**

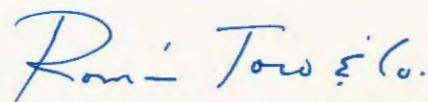
Management of Municipality of Humacao, Puerto Rico, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Humacao, Puerto Rico's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Municipality of Humacao, Puerto Rico's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiency as described in the accompanying schedule of findings and questioned costs as item 2011-III-1. 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 to those charged with governance.

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

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



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Yauco, Puerto Rico  
March 26, 2012

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

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**SECTION I – SUMMARY OF AUDITORS' RESULTS**

**Financial Statements**

Type of auditor's report issued:  Unqualified Opinion  Qualified Opinion  
 Adverse Opinion  Disclaimer Opinion

Internal control over financial reporting:

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

**Federal Awards**

Internal control over major programs:

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

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

Unqualified Opinion  Qualified Opinion  
 Adverse Opinion  Disclaimer Opinion

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

Yes  No

Identification of Major Programs:

| CFDA Number            | Name of Federal Program or Cluster                               |
|------------------------|--|
| 10.558                 | Child and Adult Care Food Program                                |
| 10.760                 | Water and Waste Disposal System for Rural Communities            |
| 14.218; 14.253         | Community Development Block Grant – Entitlement Grants (Cluster) |
| 14.871                 | Section 8 – Rental Housing Choice Vouchers                       |
| 93.600; 93.708; 93.709 | Head Start Program Cluster                                       |

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

\$531,085

Auditee qualified as low-risk auditee?

Yes  No

**END OF SECTION**

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COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)  
FOR THE YEAR ENDED JUNE 30, 2011

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**SECTION II – FINANCIAL STATEMENTS FINDINGS**

None.

**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**2011-III-1**

Type of finding: Federal award finding.

Situation: Significant deficiency; Compliance of federal regulations

Federal Program: Section 8 Housing Choice Voucher Program (14.871); and Section 8 Moderate Rehabilitation Program

Compliance Requirements: Allowable Cost/Cost Principle; Special tests and provisions.

Prior-Year(s) Audit Finding(s): None.

Questioned Costs: \$6,273 (as of June 30, 2011)

***Condition:***

\$5,457 of the Municipality's (the PHA) Section 8 HCV program's restricted cash funds (NRA/HAP) was levied by the U.S. Internal Revenue Service (IRS) in an effort to capture payroll taxes allegedly owed by the Municipality to the IRS. A total of \$816 Portability HAP and Admin Fee revenues paid by the Housing Authority of New Britain, CT to the Municipality have also been levied as of June 30, 2011. The payroll taxes in question are attributable to the Municipality's entire payroll, and not to the Section 8 program. Additionally, at the time of the levy, the Municipality had not signed a HUD-designed depository agreement with the financial institution.

***Context:***

The Municipality had invested \$100,000 of Section 8 HCV HAP/NRA reserves in an interest-bearing savings account along with \$136,407 invested by the Municipality's Section 8 Moderate Rehabilitation (Mod Rehab) program. On November 5, 2010, the IRS levied \$12,901 from the investment account, which is divided proportionately between the programs. On April 28, 2011, the IRS notified the Housing Authority of New Britain, CT to remit all payments owed to the Municipality's Section 8 program in the form of Portabilities to the IRS as part of the levy, up to the amount of \$19,205. The New Britain PHA has continued to remit all subsequent Portability payments to the IRS in order to comply with the mandate.

Since then, the Municipality has lobbied unsuccessfully to eliminate the debt and return the levy, however the IRS has not attended the Municipality's case as of our audit report date and has delayed the review because of heavy workload. As of June 30, 2011 and as of our audit report date, the Municipality has not reimbursed its Section 8 program the same amount of levied funds in order to reestablish the previous reserves while the case is being resolved.

According to IRS policy, 21 days are provided to the financial institution carrying the funds to verify the title ownership of the account before remitting the levied funds to the IRS. The Municipality had not signed a depository agreement with the financial institution over the Section 8 program's accounts at the time of the levy, which could have provided the financial institution sufficient recourse to protest the seizure because of the federally restricted funds in the account.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)  
FOR THE YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (continued)**

**2011-III-1, continued**

***Criteria:***

The PHA may only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements, as per 24 CFR section 982.156(b). Additionally, PHAs are required to enter into depository agreements with their financial institutions as required by HUD, because such agreements serve as safeguards for Federal funds and provide third-party rights to HUD, as per 24 CFR section 982.156.

***Cause:***

The IRS selected an account in the Municipality's name to seize such funds as collateral for the debt owed, and no justification has been given for the selection of the particular account belonging to the Municipality's Section 8 HCV program.

***Effect:***

The Municipality's Section 8 HCV program's HAP/NRA reserves were reduced by the levied amount. Additionally, the Municipality has paid Portabilities to participants with its reserves because of the levied monthly payments.

***Auditor's Recommendation:***

The Municipality's General Fund should reimburse the Section 8 HCV program all the funds that it lost from the IRS seizure, irrespective of the ultimate resolution of the IRS investigation over the alleged debt. The Municipality should also reach a HUD-designed Depository Agreement with the financial institution and instruct the institution to try and challenge any seizure of accounts containing HUD-sourced funds.

***Views of responsible officials and corrective actions:***

This situation has been reclaimed by our Finance Officer to IRS Agency since November 2010. An Agent authorized by IRS is in charge of our claim. The IRS wrongfully selected various bank accounts in the Municipality's name as collateral for the debt they said is owed by us, including the Section 8 HCV/NRA and Section 8 Mod Rehab programs. But these accounts are used only in connection with the program relate to, in accordance with HUD requirements. The IRS has not attended our claim and delayed the review of this case because of a lot of work they have. By February 28, 2012 they sent us a letter soliciting an additional 45 days to review and resolve our case.

In order to reestablish the reserve of Section 8 programs levied by the IRS, we will reimburse the amount of \$12,900.64 and \$19,204.90 (\$32,105.54) respectively, with municipal funds to affected accounts. Also, we will require entering into a depository agreement with our financial institutions to protect the federal funds received.

***Audit finding status:***

Unresolved.

**END OF SECTION**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF HUMACAO, PUERTO RICO  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2011

| Year | Finding Number | Finding | CFDA Number | Questioned Cost(s) | Comments |
|------|----------------|---------|-------------|--------------------|----------|
|------|----------------|---------|-------------|--------------------|----------|

**(1) Prior Audit Findings, fully corrected or not noted during our audit:**

|      |            |   |        |       |   |
|------|------------|---|--------|-------|---|
| 2010 | 2010-III-1 | The Municipality did not prepare a cost or price analysis for the bidding process when only one eligible bidder was selected. | 10.558 | None. | This situation was not noted in our tests of this year's audit. |
|------|------------|---|--------|-------|---|

**(2) Prior Audit Findings, not corrected or partially corrected:**

None.

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

None.

**(4) Prior Audit Findings, are no longer valid:**

None.

END OF SCHEDULE



**MUNICIPIO DE HUMACAO**

**Informe Especial sobre el cumplimiento con las  
recomendaciones del Contralor y la corrección de las  
fallas señaladas en los Informes de Auditoría  
M-10-23 del 24 de noviembre de 2009 y  
M-10-32 del 9 de diciembre de 2009**

**26 de marzo de 2012**



## MUNICIPIO DE HUMACAO

### CONTENIDO

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| ALCANCE Y METODOLOGIA  | 2   |
| INFORME DE LOS AUDITORES INDEPENDIENTES  | 2-3 |
| CARTAS A LA GERENCIA   | 3   |
| COMENTARIOS DE LA GERENCIA   | 3   |
| AGRADECIMIENTO   | 3   |
| ANEJO A:<br>Recomendaciones no cumplimentadas y<br>parcialmente cumplimentadas |     |

26 de marzo de 2012

Hon. Alcalde  
Municipio de Humacao  
Humacao, Puerto Rico

Realizamos una auditoría, que incluyó la realización de aquellos procedimientos que consideramos necesarios, para expresar una opinión sobre el cumplimiento del Municipio con las recomendaciones del Contralor y la corrección de las fallas señaladas en los Informes de Auditoría **M-10-23 del 24 de noviembre de 2009** y **M-10-32 del 9 de diciembre de 2009**. La misma se efectuó a base de las disposiciones que se establecen en los **artículos 7.010 y 8.016 de la Ley Núm. 81 del 30 de agosto de 1991, Ley de Municipios Autónomos del Estado Libre Asociado de Puerto Rico de 1991, según enmendada (Ley Núm. 81)**.

#### **BASE LEGAL**

El 8 de marzo de 2011 el Municipio contrató los servicios de esta firma para realizar la auditoría de sus estados financieros de acuerdo con los requisitos del **Single Audit Act** y a tenor con la **Ley Núm. 81 y el Reglamento Revisado sobre Normas Básicas para los Municipios de Puerto Rico**. Este fue aprobado por el Comisionado de Asuntos Municipales el 30 de junio de 1995 y comenzó a regir el 31 de julio de 1995.

## ALCANCE Y METODOLOGIA

La auditoría cubrió del 1 de julio de 2010 al 30 de junio de 2011. El examen se realizó de acuerdo con las normas de auditoría generalmente aceptadas promulgadas en las **Normas de Auditoría Gubernamental emitidas por el Contralor General de los Estados Unidos, el Manual de Normas de Auditoría del Contralor de Puerto Rico y el Instituto Americano de Contadores Públicos Autorizados** en lo que concierne al cumplimiento con las recomendaciones y la corrección de las fallas señaladas en los Informes de Auditoría **M-10-23 del 24 de noviembre de 2009 y M-10-32 del 9 de diciembre de 2009**. Efectuamos las pruebas que consideramos necesarias de acuerdo con las circunstancias. Además, como parte de nuestro examen, asistimos el 5 de octubre de 2011 a la orientación ofrecida por la Oficina del Contralor sobre el cumplimiento con las recomendaciones del Contralor y la corrección de las fallas señaladas en los Informes de Auditoría **M-10-23 del 24 de noviembre de 2009 y M-10-32 del 9 de diciembre de 2009**.

## INFORME DE LOS AUDITORES INDEPENDIENTES

Hemos examinado el cumplimiento del Municipio de Humacao con las recomendaciones del Contralor de Puerto Rico emitidas en sus informes **M-10-23 del 24 de noviembre de 2009 y M-10-32 del 9 de diciembre de 2009**. La gerencia es responsable de que el Municipio de Humacao cumpla con estas recomendaciones. Nuestra responsabilidad es la de expresar una opinión sobre el cumplimiento del Municipio de Humacao basado en nuestro examen.

Nuestro examen fue realizado de acuerdo a las normas de atestación promulgadas por el Instituto Americano de Contadores Públicos Autorizados y, por lo tanto, incluyó examinar, a base de pruebas, evidencia acerca del cumplimiento del Municipio de Humacao con las recomendaciones mencionadas en el primer párrafo y la realización de cualquier otro procedimiento que consideramos necesario según las circunstancias. Nosotros creemos que nuestro examen provee una base razonable para nuestra opinión. Nuestra opinión no representa una base legal para determinar el cumplimiento del Municipio de Humacao con las recomendaciones que se especifican en el primer párrafo.

Nuestro examen reveló las áreas de no cumplimiento con las recomendaciones del Contralor de Puerto Rico emitidas en sus informes **M-10-23 del 24 de noviembre de 2009** y **M-10-32 del 9 de diciembre de 2009** que se incluyen en el anejo de recomendaciones no cumplimentadas y parcialmente cumplimentadas que se acompaña, para el año terminado el 30 de junio de 2011.

En nuestra opinión, excepto por las áreas de no cumplimiento señaladas en el anejo al que hace referencia el tercer párrafo, el Municipio de Humacao cumplió, en todos los aspectos materiales, con las recomendaciones que se especifican en el primer párrafo, para el año terminado el 30 de junio de 2011.

Este informe es emitido para conocimiento y uso exclusivo de la Oficina del Contralor de Puerto Rico y del Municipio de Humacao en relación al cumplimiento con los Artículos 7.010 y 8.016 de la Ley de Municipios Autónomos del Estado Libre Asociado de Puerto Rico y no debe ser utilizado para ningún otro propósito.

### **CARTAS A LA GERENCIA**

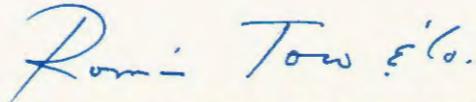
Los hallazgos de este informe se sometieron al Alcalde, Hon. Marcelo Trujillo Panisse, para comentarios.

### **COMENTARIOS DE LA GERENCIA**

Las situaciones presentadas en los Hallazgos de los Informes M-10-23 y M-10-32 considerados Parcialmente Cumplimentados y los No Cumplimentados actualmente están siendo evaluadas por los auditores de la Oficina del Contralor durante el proceso de auditoría que llevan a cabo en nuestro Municipio. No obstante, daremos seguimiento a las acciones correctivas de los hallazgos que se presenten relacionados con estos informes y a aquellas situaciones que se incluyan en las cartas que nos envíen los auditores.

### **AGRADECIMIENTO**

A los funcionarios y empleados del Municipio de Humacao les agradecemos la cooperación que nos prestaron durante nuestro examen.



ROMAN TORO & CO., CONTADORES  
PUBLICOS AUTORIZADOS, CSP  
LICENCIA #35 - VIGENTE

Yauco, Puerto Rico  
26 de marzo de 2012

La estampilla #E18589 fue adherida  
al original de este informe

**MUNICIPIO DE HUMACAO**

**ANEJO A:**

***Recomendaciones No Cumplimentadas y  
Parcialmente Cumplimentadas***

**INFORME ESPECIAL – CONTRALOR**

**30 de junio de 2011**

**MUNICIPIO DE HUMACAO**  
**INFORME ESPECIAL - CONTRALOR**  
**ANEJO DE RECOMENDACIONES NO CUMPLIMENTADAS Y**  
**PARCIALMENTE CUMPLIMENTADAS**  
**30 DE JUNIO DE 2011**

**Informe M-10-23 emitido el 24 de noviembre de 2009**

| <i>Número de Recomendación/Hallazgo</i> | <i>Recomendaciones de la Oficina del Contralor</i>   | <i>Estatus del Hallazgo</i> | <i>Comentarios del Auditor Externo</i>   |
|---|--|-----------------------------|--|
| Recomendación 6<br>Hallazgo 2           | Recobrar de los ex empleados concernientes o de las fianzas de los funcionarios responsables, los \$1,047 pagados indebidamente a cinco ex empleados, por sueldos y aportaciones patronales después que éstos habían cesados en sus puestos. | Parcialmente cumplimentado  | La oficina de recaudaciones del Departamento de Finanzas ha logrado cobrar parte de las cantidades, y continúan con sus gestiones de cobro. El caso también ha sido referido a División Legal para acciones pertinentes.   |
| Recomendación 7a<br>Hallazgo 2          | Asegurarse de que se corrijan las deficiencias relacionadas con los nombramientos de los empleados transitorios por períodos que exceden los términos establecidos.  | Parcialmente cumplimentado  | El Municipio se encuentra trasladando los empleados transitorios señalados a puestos permanentes.  |
| Recomendación 4a-4<br>Hallazgo 4        | Ejercer una supervisión eficaz sobre las funciones del Director de Finanzas para asegurarse de que corrija las deficiencias relacionadas con las faltas de control sobre las recaudaciones.  | No cumplimentado            | El Municipio se encuentra implementando cambios en los sistemas de recaudaciones. La Oficina de Auditoría Interna del Municipio encontró deficiencias en los sistemas actuales en su informe OAI-11-01 emitido el 16 de agosto del 2010, y en su investigación especial de seguimiento emitida el 7 de febrero del 2012. |

**MUNICIPIO DE HUMACAO**  
**INFORME ESPECIAL - CONTRALOR**  
**ANEJO DE RECOMENDACIONES NO CUMPLIMENTADAS Y**  
**PARCIALMENTE CUMPLIMENTADAS**  
**30 DE JUNIO DE 2011**

**Informe M-10-23 emitido el 24 de noviembre de 2009, continuación**

| <i>Número de Recomendación/Hallazgo</i> | <i>Recomendaciones de la Oficina del Contralor</i>   | <i>Estatus del Hallazgo</i> | <i>Comentarios del Auditor Externo</i>   |
|---|--|-----------------------------|--|
| Recomendación 8<br>Hallazgo 4           | Establecer los controles internos necesarios para las operaciones relacionadas con las recaudaciones en el Centro de Diagnóstico y Tratamiento (CDT). Esto debe incluir, entre otras medidas, auditorías periódicas de dichas operaciones y adiestramiento y supervisión de personal que interviene en las mismas de manera que no se repitan situaciones como la comentada. | No cumplimentado            | El Municipio se encuentra implementando cambios en los sistemas de recaudaciones. La Oficina de Auditoría Interna del Municipio encontró deficiencias en los sistemas actuales en su informe OAI-11-01 emitido el 16 de agosto del 2010, y en su investigación especial de seguimiento emitida el 7 de febrero del 2012. |
| Recomendación 7b<br>Hallazgo 5          | Asegurarse de que se corrijan las deficiencias relacionadas con las tareas conflictivas relacionadas con las operaciones del Sistema Mecanizado de Contabilidad.   | No cumplimentado            | El Municipio no acepta el hallazgo, y el personal señalado continúa con las mismas tareas.   |
| Recomendación 7d<br>Hallazgo 7          | Asegurarse de que se corrijan las deficiencias relacionadas con los fondos especiales inactivos.   | Parcialmente cumplimentado  | El Departamento de Finanzas continúa en su reconciliación e identificación de fondos especiales.   |

**MUNICIPIO DE HUMACAO**  
**INFORME ESPECIAL - CONTRALOR**  
**ANEJO DE RECOMENDACIONES NO CUMPLIMENTADAS Y**  
**PARCIALMENTE CUMPLIMENTADAS**  
**30 DE JUNIO DE 2011**

**Informe M-10-32 emitido el 9 de diciembre de 2009**

| <i>Número de Recomendación/Hallazgo</i> | <i>Recomendaciones de la Oficina del Contralor</i>  | <i>Estatus del Hallazgo</i> | <i>Comentarios del Auditor Externo</i>  |
|---|---|-----------------------------|---|
| Recomendación 9b<br>Hallazgo 3          | Recobrar de los contratistas, los proveedores y otros, o de las fianzas de los funcionarios responsables los \$3,675 pagados indebidamente a un contratista por servicios de alquiler de equipo para sonido no brindados. | No cumplimentado            | El Municipio rechaza el hallazgo, pero continúa con sus gestiones de cobro, y considera utilizar sus recursos legales para agilizar los mismos. |